

**FINANCIAL STATEMENTS AND REQUIRED
SUPPLEMENTARY INFORMATION**

**West Virginia Retiree Health Benefit Trust Fund
Years Ended June 30, 2008 and 2007
With Report of Independent Auditors**

West Virginia Retiree Health Benefit Trust Fund
Financial Statements and Required Supplementary Information
Years Ended June 30, 2008 and 2007

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Report of Independent Auditors

The Finance Board
West Virginia Retiree Health Benefit Trust Fund

We have audited the accompanying statements of plan net assets of the West Virginia Retiree Health Benefit Trust Fund (RHBT), a fiduciary fund of the State of West Virginia, as of June 30, 2008 and 2007, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of RHBT'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 RHBT'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 RHBT'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 RHBT are intended to present the financial position and the changes in financial position of only that portion of the activities of the State that is attributable to the transactions of the RHBT. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2008 and 2007, and the changes in its financial position, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of RHBT, a fiduciary fund of the State of West Virginia, at June 30, 2008 and 2007, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 23, 2009 on our consideration of RHBT'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 audit.

The management's discussion and analysis on pages 3 through 7 and the unaudited supplemental schedules of funding progress and employer contributions on pages 28 and 29 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 audits of the basic financial statements were conducted for the purpose of forming an opinion on the basic financial statements of RHBT, 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 RHBT. Such information has been subjected to the auditing procedures applied in the 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.

Ernst + Young LLP

March 23, 2009

West Virginia Retiree Health Benefit Trust Fund

Management's Discussion and Analysis

Year Ended June 30, 2008

This section of the annual financial report of the West Virginia Retiree Health Benefit Trust Fund (RHBT) presents a discussion and analysis of the financial performance of RHBT for the year ended June 30, 2008. Please read it in conjunction with the basic financial statements, which follow this section.

OVERVIEW OF THE FINANCIAL STATEMENTS

RHBT was established by West Virginia Code section 5-16D-2 and began its first fiscal year July 1, 2006.

The primary purpose of RHBT is to preserve in an irrevocable trust certain dedicated revenues for the funding of the State of West Virginia (State) defined benefit cost-sharing multiemployer Other Postemployment Benefit (OPEB) plan (the Plan). Funds made available to RHBT are to be used exclusively for the payment of OPEB obligations. The Plan provides group health and prescription drug insurance for retirees of State agencies, colleges and universities, county boards of education, and other government entities as set forth in the West Virginia Code (Employers). RHBT is a fiduciary fund of the State. The basic financial statements are presented on the accrual basis of accounting. The two basic financial statements presented within the financial statements are as follows:

Statement of Plan Net Assets – This statement presents information reflecting RHBT's assets, liabilities, and plan net assets. Plan net assets represent the amount of total assets less total liabilities. The statement of plan 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 Changes in Plan Net Assets – This statement reflects RHBT's operating revenues and expenses, as well as nonoperating revenues during the operating year. The major source of operating revenues is premium income, while major expense areas include medical and prescription drug claims costs.

West Virginia Retiree Health Benefit Trust Fund

Management's Discussion and Analysis (continued)

FINANCIAL HIGHLIGHTS

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

	2008	2007	Change 2008 – 2007	
			Amount	Percent
Cash and cash equivalents	\$ 59,311,378	\$ 6,248,304	\$ 53,063,074	849.2%
Due from PEIA	–	3,623,421	(3,623,421)	(100.0%)
Contribution receivable	11,194,695	4,383,893	6,810,802	155.4%
Other receivables	1,012,075	5,337,983	(4,325,908)	(81.0%)
Investments	198,496,665	–	198,496,665	100.0%
Total assets	270,014,813	19,593,601	250,421,212	1,278.1%
Claims payable	7,060,000	16,400,000	(9,340,000)	(57.0%)
Due to PEIA	7,178,892	–	7,178,892	100.0%
Other liabilities	958,188	26,650	931,538	3,495.5%
Total liabilities	15,197,080	16,426,650	(1,229,570)	(7.5%)
Net assets held in trust for other postemployment benefits	254,817,733	3,166,951	251,650,782	7,946.2%
Total net assets	\$ 254,817,733	\$ 3,166,951	\$ 251,650,782	7,946.2%
Additions:				
Contributions				
Employers	\$ 324,098,028	\$ 125,146,362	\$ 198,951,666	159.0%
Plan members	60,872,104	63,590,714	(2,718,610)	(4.3%)
Total contributions	384,970,132	188,737,076	196,232,056	104.0%
Retiree drug subsidy	437,496	19,369,600	(18,932,104)	(97.7%)
Investment income	583,712	74,974	508,738	678.6%
Total additions	385,991,340	208,181,650	177,809,690	85.4%
Deductions:				
Payments to managed care organizations	57,996,400	4,699,405	(53,296,995)	1,134.1%
Claims expense, net	70,215,497	191,571,044	121,355,547	(63.3%)
Administrative service fees	1,761,944	4,517,892	2,755,948	(61.0%)
Other expenses	4,366,717	4,226,358	(140,359)	3.3%
Total deductions	134,340,558	205,014,699	70,674,141	(34.5%)
Change in net assets	251,650,782	3,166,951	248,483,831	7,846.2%
Net assets held in trust for other postemployment benefits:				
Beginning of period	3,166,951	–	3,166,951	100.0%
End of period	\$ 254,817,733	\$ 3,166,951	\$ 251,650,782	7,946.2%

West Virginia Retiree Health Benefit Trust Fund

Management's Discussion and Analysis (continued)

Effective with the fiscal year beginning July 1, 2007, all Medicare covered individuals who have health care insurance through RHBT were transferred to a Medicare Advantage Prescription Drug (MAPD) plan. These individuals and their dependents were previously covered by the preferred provider benefit (PPB) indemnity plan where Medicare medical claims were paid on a secondary basis, after Medicare paid primary. The drug claims were insured by RHBT, which collected a retiree drug subsidy from the Centers for Medicare and Medicaid Services (CMS) as compensation for prescription drug costs which would have been otherwise covered under the Medicare Part D plan.

Approximately 36,000 Medicare insured individuals were moved to the MAPD plan effective July 1, 2007, while non-Medicare retirees and dependents continued coverage with the PPB indemnity plan. The MAPD plan collects monthly capitation payments from Medicare and RHBT for each Medicare policyholder. Because the Medicare policyholder drug claims are paid by the MAPD plan, it will collect the CMS retiree drug subsidy. Risk relating to the Medicare policyholders has been ceded to the MAPD plan and is no longer considered a liability to RHBT.

Cash and cash equivalents increased approximately \$53.1 million as the result of an increase of \$177.8 million in total additions, a decrease of \$70.7 million in deductions, less \$198.5 million moved to investments, reduced by \$1.2 million pay-down of liabilities, a \$1.1 million reduction of other assets and current year operating results. In the prior year, cash and cash equivalents increased \$6.2 million due to a \$3.2 million result from operations reduced by \$13.4 million uncollected receivables and increased by \$16.4 million unpaid liabilities.

Due from West Virginia Public Employees Insurance Agency (PEIA) decreased \$10.8 million and became a liability to PEIA. PEIA paid certain claims and expenses for RHBT and had not been reimbursed as of the current year-end. At year-end 2007 PEIA had collected certain funds that belonged to RHBT and not yet remitted as of year-end.

Contributions receivable increased \$6.8 million as of year-end 2008 due to an increase in premium rates and some slowdown in payments due to the adoption of a new remittance procedure. As of the end of the prior year, contributions receivable were at \$4.4 million as the result of normal timing of the collection process.

Current year-end other receivables decreased \$4.3 million as the result of collection of retiree drug subsidies from Medicare. The prior year other receivables consisted of the uncollected retiree drug subsidy discussed above and certain other drug rebates receivable.

Investments increased \$198.5 million as funds generated in the current year not needed for operations were placed in a portfolio with the West Virginia Investment Management Board. There were no investments at year-end 2007.

West Virginia Retiree Health Benefit Trust Fund

Management's Discussion and Analysis (continued)

Claims payable liability decreased \$9.3 million because Medicare covered member claims costs were transferred to the MAPD to the extent that they were incurred in the current year. As of year-end 2007, the first year of operation, claims had been incurred but not yet paid in the amount of \$16.4 million.

Other liabilities increased \$.9 million primarily as the result of certain unpaid capitation due to the MAPD. The prior year-end amount was not material.

For the year-end 2008, employer contributions were up \$199.0 million as the result of \$108.2 million excess reserves transferred from PEIA, \$45.5 million transferred from the State of West Virginia, \$39.0 million increase in premium rates and changes in enrollment costs. In the prior year, employer contributions totaling \$125.1 million had been billed.

Current year plan member contributions are down \$2.7 million primarily due to changes. Year-end 2007 resulted in a \$63.6 million total member billing.

The retiree drug subsidy decreased \$18.9 million because the Medicare covered member risk was ceded to the MAPD which is now responsible for the related drug claims. Drug claims incurred in year-end 2007 were the responsibility of RHBT; therefore, it collected the subsidy.

Investment income increased \$.5 million due to the placing of investments discussed above and higher cash levels. Year-end 2007 investment income resulted from interest earned on cash balances.

Payments to managed care organizations increased \$53.3 million as the result of movement of the Medicare risk to the MAPD. Prior-year payments to managed care organizations represent capitation paid for non-Medicare covered retirees.

Claims expense was down \$121.4 million because the Medicare covered member risk was transferred to the MAPD. In the prior year, total claims incurred for both Medicare and non-Medicare retirees totaled \$191.6 million.

Administrative service fees declined \$2.8 million because Medicare claims are no longer adjudicated by our third-party administrators. For the prior year, administrative service fees reached \$4.5 million for both Medicare and non-Medicare retiree claims.

Other operating expenses increased \$.1 million as the result of normal cost increases. In the prior year, other operating expenses totaled \$4.2 million.

West Virginia Retiree Health Benefit Trust Fund

Management's Discussion and Analysis (continued)

ECONOMIC CONDITIONS

The rate of health care cost inflation is directly driven by new and more expensive medical technology including medical equipment and prescription drugs, direct to the consumer advertising, and the reluctance of employers and policyholders to limit their financial exposure.

The OPEB liability, Actuarial Accrued Liability (AAL), at June 30, 2008, has been estimated at \$6.4 billion based on calculations as prescribed in Governmental Accounting Standards Board (GASB) Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. This amount represents a substantial unfunded liability for the Employers. The Employers are evaluating options to address this unfunded obligation and fulfill commitments made to current and retired employees and attract and retain quality governmental employees in the future. The State has demonstrated its intent to deal with the substantial unfunded liability by the passage of Senate Bill 129, which became effective July 1, 2007. This bill amended West Virginia Code (the Code) Section 5-16-25, indicating that the PEIA excess reserve funds shall be transferred to RHBT. Funds totaling \$108.2 million were transferred to the Plan in fiscal year 2008 related to this provision in the Code.

REQUESTS FOR INFORMATION

This financial report is designed to provide RHBT's participants, governing officials, legislators, citizens, and taxpayers with a general overview of RHBT's accountability for the money it receives. If you have any questions about this report or need additional information, contact the Chief Financial Officer at (304) 558-7850, ext. 242.

West Virginia Retiree Health Benefit Trust Fund

Statements of Plan Net Assets

	June 30	
	2008	2007
Assets		
Cash and cash equivalents	\$ 59,311,378	\$ 6,248,304
Due from PEIA	–	3,623,421
Contributions receivable – net of allowance for doubtful accounts of \$4,200,000 and \$1,300,000	11,194,695	4,383,893
Other receivables:		
Prescription rebates, net of allowance of \$0 and \$727,000	565,719	888,780
Retiree drug subsidy	446,356	4,449,203
Investments	198,496,665	–
Total assets	<u>270,014,813</u>	19,593,601
Liabilities		
Claims payable	7,060,000	16,400,000
Other liabilities	958,188	26,650
Due to PEIA	7,178,892	–
Total liabilities	<u>15,197,080</u>	16,426,650
Net assets held in trust for other postemployment benefits	<u>\$ 254,817,733</u>	<u>\$ 3,166,951</u>

See accompanying notes.

West Virginia Retiree Health Benefit Trust Fund

Statements of Changes in Plan Net Assets

	Year Ended June 30	
	2008	2007
Additions		
Contributions:		
Employers	\$ 324,098,028	\$ 125,146,362
Plan members	60,872,104	63,590,714
Total contributions	384,970,132	188,737,076
Other additions:		
Retiree drug subsidy	437,496	19,369,600
Interest and dividend income	3,045,525	74,974
Net depreciation in fair value of investments	(2,461,813)	—
Total additions	385,991,340	208,181,650
Deductions		
Payments to managed care organizations	57,996,400	4,699,405
Claims expense, net	70,215,497	191,571,044
Administrative service fees	1,761,944	4,517,892
Other operating expenses	4,366,717	4,226,358
Total deductions	134,340,558	205,014,699
Net increase	251,650,782	3,166,951
Net assets held in trust for other postemployment benefits:		
Beginning of period	3,166,951	—
End of period	\$ 254,817,733	\$ 3,166,951

See accompanying notes.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements

June 30, 2008

1. Reporting Entity

The West Virginia Retiree Health Benefit Trust Fund (RHBT) was established under West Virginia Code section 5-16D-2 and began its first year of operations July 1, 2006. RHBT is an irrevocable trust fund of the State of West Virginia (State) and, accordingly, is reported as a fiduciary fund of the primary government in the State's Comprehensive Annual Financial Report (CAFR).

The basic financial statements of the RHBT are intended to present the financial position and the changes in financial position of only that portion of the activities of the State that is attributable to the transactions of RHBT. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2008, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

2. Plan Description and Contribution Information

The Plan is a cost-sharing, multiemployer, defined benefit other postemployment benefit plan and 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 (the Code). Financial activities of the Plan are accounted for in the RHBT. The Plan is administered by a combination of the West Virginia Public Employees Insurance Agency (PEIA) and the RHBT staff. Plan benefits are established and revised by PEIA and RHBT management with the approval of their Finance Boards. The Plan provides the following retiree group insurance coverage to participants: medical and prescription drug coverage through a self-insured preferred provider benefit (PPB) plan and through external managed care organizations (MCOs), 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. Additionally, all retirees may elect to purchase additional life insurance under the optional life insurance policy. Survivors of retirees have the option of purchasing the medical and prescription drug coverage.

For participants who elect coverage through MCOs, RHBT collects contributions from employers and remits a capitation fee to an MCO carrier. The capitation fees paid by RHBT to each MCO are in accordance with their respective contracts. Benefits are the responsibility of each MCO carrier and are not reflected in the accompanying financial statements. The contributions earned by RHBT have been included in employer and plan member contributions while the capitation fees submitted to each MCO carrier are reflected as payments to MCOs as a deduction on the financial statements.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

2. Plan Description and Contribution Information (continued)

Members may obtain optional life insurance coverage from \$2,500 to \$150,000 depending on age; however, optional AD&D insurance is not available. Members may also elect dependent optional life coverage at levels up to \$20,000 for spouse and \$10,000 per child. Amounts collected by RHBT from members for optional coverage totaled \$8,983,603 during the fiscal year ended June 30, 2008, and were remitted directly to the carrier. RHBT functions as an agent for these optional benefits and, accordingly, neither these premiums nor the related costs are reflected in the financial statements.

Effective with the fiscal year beginning July 1, 2007, all Medicare covered individuals who have health care insurance through RHBT were transferred to a Medicare Advantage Prescription Drug (MAPD) plan administered by RHBT. These individuals and their dependents were previously covered by the preferred provider benefit (PPB) indemnity plan where Medicare medical claims were paid on a secondary basis, after Medicare paid primary, and drug claims were insured by RHBT, which collected a retiree drug subsidy from Medicare as compensation for prescription drug costs which would have been otherwise covered under the Medicare Part D plan. Approximately 36,000 Medicare insured individuals were moved to the MAPD plan effective July 1, 2007, while non-Medicare retirees and dependents continued coverage with the PPB indemnity plan. The MAPD plan collects monthly capitation payments from Medicare and RHBT for each Medicare policyholder. Because the Medicare policyholder drug claims are paid by the MAPD plan, it collects the retiree drug subsidy. Risk relating to the Medicare covered individuals has been ceded to the MAPD plan and is no longer considered a liability to RHBT.

Membership consists of the following as of June 30, 2008, the date of the last actuarial valuation:

Retirees and beneficiaries receiving benefits	33,508
Active plan members	<u>73,070</u>
Total member count	<u>106,578</u>
Number of participating employers	579

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

2. Plan Description and Contribution Information (continued)

West Virginia Code section 5–16D–6 also assigns to the PEIA and RHBT Finance Boards the authority to establish and amend contribution requirements of the plan members and the participating employers. Participating employers are required by statute to contribute at a rate assessed each year by RHBT. The annual contractually required rate for State general revenue fund agencies and other participating employers was set at \$272.96 and \$340.47 per active employee per month effective July 1, 2007. While, the annual contractually required rate for State agencies and other participating employers was at \$266.97 and \$388.31 per active policyholder per month effective July 1, 2008.

A non-Medicare plan member or beneficiaries receiving benefits contributes monthly health care premiums ranging from \$208 to \$744 per month for retiree-only coverage, and from \$416 to \$1,772 per month for retiree and spouse coverage. Medicare covered retirees are charged health care premiums ranging from \$46 to \$339 per month for retiree-only coverage, and from \$69 to \$1,156 per month for retiree and spouse coverage. Monthly premiums vary based on years of service and choice of coverage.

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 to provide future plan stability. In the event the reserve fund exceeds certain parameters specified in the Code, the excess is to be remitted to RHBT in accordance with Senate Bill 129, which became effective July 1, 2007. Approximately \$27.7 million and \$80.5 million were transferred to RHBT in September 2007 and January 2008, respectively, related to such excess reserve funds.

3. Summary of Significant Accounting Policies

Basis of Reporting

RHBT is accounted for as a fiduciary fund. Accordingly, the basic financial statements are prepared using the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America for governmental entities as prescribed or permitted by the Governmental Accounting Standards Board (GASB). RHBT implemented GASB 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, in 2007 as part of its initial basic financial statement presentation. Revenues are derived mainly from

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

3. Summary of Significant Accounting Policies (continued)

contributions from plan members and employer contributions. Members' contributions are recognized in the period in which the contributions are due. Employer contributions and related receivables to the Trust are recognized pursuant to a formal commitment from the employer or statutory contractual requirement, when there is a reasonable expectation of collection. Benefits and refunds are recognized when due and payable.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from management's estimates.

Budgetary Requirements

The Code requires the RHBT Finance Board (the Board) to set the annual required contribution sufficient to maintain the fund in an actuarially sound manner. The Board shall annually allocate to the respective employers the employers' portion of the annual required contribution.

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 Board of Treasury Investments (BTI) that are pooled funds. RHBT makes interest-earning deposits in the cash liquidity pools that are available to RHBT with overnight notice. Interest income is prorated to RHBT at rates specified by BTI based on the balance of RHBT's deposits maintained in relation to the total deposits of all state agencies participating in the pool.

Market risk exists as the value of the investment pools underlying investment assets may decline because of an increase in interest rates or a decline in bond prices. The carrying value of the deposits reflected in the financial statements approximates fair value and approximates the value of the shares in the external investment pool.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

3. Summary of Significant Accounting Policies (continued)

A five-member Board of Directors governs the BTI. The State Governor, State Treasurer, and State 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 Web site 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.

Due To/From PEIA

This balance represents the deficiency or excess of RHBT contributions collected by PEIA over expenses paid by PEIA for RHBT.

Contributions Receivable

All contributions receivable are reported net of an allowance for amounts estimated to be uncollectible based on management's review of the payment status of the underlying accounts and other economic factors that are deemed necessary in the circumstances.

Prescription Drug Rebates

Through arrangements with its Prescription Benefit Manager (PBM), RHBT collects rebates from prescription drug manufacturers. The estimated prescription rebates receivable is based on prescription claims counts and historical average rebate per claim. The receivable has been reduced by the estimated portion that is expected to be uncollectible based on management's review of the payment status of the underlying accounts and other factors that are deemed necessary in the circumstances.

Retiree Drug Subsidy

RHBT recorded retiree drug subsidy (RDS) revenue from the federal government under the provisions of Medicare Part D of \$437,496 and \$19,369,600 for the years ended June 30, 2008 and 2007, respectively. The RDS revenue has been accounted for as voluntary nonexchange transactions in accordance with GASB technical bulletin 2006-1. Accordingly, RDS estimated revenue is recognized as RHBT incurs Medicare-eligible retiree prescription drug expenditures.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

3. 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 due and payable 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 for services provided but not yet reported or processed for settlement). The estimated actuarial liability reflects certain assumptions, which include such factors as enrollment and utilization. Adjustments to the estimated actuarial liability for the final settlement of claims will be reflected in the year that actual results of the settlement of the claims are made and are known. The estimated liability is adjusted periodically based on the most current claim incurrence and claim settlement history.

Claims relating to participants in MCOs, as well as claims relating to participants covered under the optional life insurance plan, are not considered in the liability as RHBT 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, RHBT is responsible for such liability. Claims expense is reported net of pharmacy rebate income of \$1,913,781 and \$3,343,595 for the years ended June 30, 2008 and 2007, respectively.

Administrative Service Fees

Plan administrative costs are paid by the Trust. RHBT contracts with and pays administrative service fees to two third-party administrators. Contracts are either on an annual or biannual basis. 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 members without regard to the period in which a claim is incurred.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

3. Summary of Significant Accounting Policies (continued)

Other Operating Expenses

As previously mentioned, RHBT and PEIA jointly share administrative duties relating to the 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 membership count between PEIA and RHBT. Personnel expenses attributable to RHBT full-time dedicated employees are charged in full to RHBT; while the balance of the combined personnel expense is allocated between the two entities based on estimated time requirements.

4. Deposit and Investment Risk Disclosures

WV Money Market Pool (formerly Cash Liquidity Pool)

Credit Risk

The BTI limits exposure to credit risk by requiring all corporate bonds held by their WV 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 U.S. Treasury issues.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

4. Deposit and Investment Risk Disclosures (continued)

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

Security Type	June 30, 2008				June 30, 2007			
	Credit Rating		Carrying Value	Percent of Pool Assets	Credit Rating		Carrying Value	Percent of Pool Assets
	Moody's	S&P			Moody's	S&P		
Commercial paper	P1	A-1	\$ 658,879	27.94%	P1		\$ 1,015,926	48.89%
Corporate bonds and notes	Aaa	AAA	40,000	1.70	Aaa	AAA	98,999	4.76
	Aa3	AA	20,000	0.85	Aa3	AA	20,001	0.96
			–	–	Aa3	A	23,002	1.11
			–	–	Aa2	AA	15,000	0.72
	Aa2	A	27,000	1.14	Aa2	A	27,000	1.30
	Aa1	AA	71,000	3.01	Aa1	AA	77,023	3.71
		<u>158,000</u>	<u>6.70</u>			<u>261,025</u>	<u>12.56</u>	
U.S. agency bonds	Aaa	AAA	254,019	10.77	Aaa	AAA	46,994	2.26
U.S. Treasury bills	Aaa	AAA	406,426	17.23	Aaa	AAA	358,725	17.27
Negotiable certificates of deposit	P1	A-1	147,001	6.23	P1	A-1	76,500	3.68
U.S. agency discount notes	P1	A-1	212,924	9.03	P1	A-1	21,655	1.04
Money market funds	Aaa	AAA	150,058	6.36	Aaa	AAA	185	0.01
Repurchase agreements (underlying securities):								
U.S. agency notes	Aaa	AAA	308,898	13.10	Aaa	AAA	246,821	11.88
U.S. Treasury notes	Aaa	AAA	62,265	2.64			–	–
Total repurchase agreements			<u>371,163</u>	<u>15.74</u>			<u>246,821</u>	<u>11.88</u>
Total investments			<u>2,358,470</u>	<u>100.00</u>			<u>2,027,831</u>	<u>97.59</u>
Deposits:								
Non-negotiable certificates of deposit			–	–	NR*	NR*	50,000	2.41
			<u>\$ 2,358,470</u>	<u>100.00%</u>			<u>\$ 2,077,831</u>	<u>100.00%</u>

*NR = Not Rated

Not rated securities include repurchase agreements which are collateralized by U.S. Treasury and government agency securities, all of which carry a high credit rating.

The BTI limits the exposure to credit risk in the WV Money Market pool by requiring all corporate bonds 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. The WV Money Market pool has not been rated for credit risk by any organization.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

4. Deposit and Investment Risk Disclosures (continued)

Concentration of Credit Risk

West Virginia statutes prohibit the BTI pools from investing more than 5% of its assets in securities issued by a single private corporation or association. At June 30, 2008 and 2007, the WV Money Market pool did not have investments in any one private corporation or association that represented more than 5% of assets.

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.

Interest Rate Risk

The weighted-average maturity of the investments of the WV Money Market pool cannot exceed 60 days. The maturity of individual securities cannot exceed 397 days from the date of purchase. The following table provides the weighted-average maturities (WAM) for the various asset types in the WV Money Market pool.

Security Type	June 30, 2008		June 30, 2007	
	Carrying Value	WAM (Days)	Carrying Value	WAM (Days)
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
Repurchase agreements	\$ 371,163	1	\$ 246,821	2
U.S. Treasury bills	406,426	31	358,725	30
Commercial paper	658,879	29	1,015,926	52
Certificates of deposit	147,001	95	126,500	76
U.S. agency discount notes	212,924	84	21,655	113
Corporate notes	158,000	21	261,025	58
U.S. agency bonds/notes	254,019	111	46,994	156
Money market funds	150,058	1	185	1
Total investments	<u>\$ 2,358,470</u>	<u>40</u>	<u>\$ 2,077,831</u>	<u>48</u>

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

4. Deposit and Investment Risk Disclosures (continued)

Foreign Currency Risk

None of the BTI WV Money Market pool investment interests are in foreign currencies or interests valued in foreign currencies.

RHBT's investment in the BTI WV Money Market pool of \$50,114,089 and \$6,219,455 at June 30, 2008 and 2007, represents approximately 2% and 0.3% of total investments in this pool.

Investments

Liquidity Needs and Investment Objectives

The RHBT is expected to have minimal liquidity needs until fiscal year 2011, upon which time annual liquidity needs are expected to increase. The investment objective is to provide for stable, long-term growth of assets, while seeking to minimize risk of loss. There is no specifically identified rate of return target.

RHBT's investments are managed by the West Virginia Investment Management Board (WVIMB). Investments at cost and as reported at fair value (actual asset allocation) are summarized as follows at June 30, 2008 (in thousands):

	<u>Fair Value</u>
Large cap domestic equity pool	\$ 5,430
Non-large cap domestic equity pool	757
International equity pool	2,374
Fixed income pool	118,132
Fixed income nonqualified pool	71,611
Short-term fixed income pool	193
	<u>\$ 198,497</u>

West Virginia Retiree Health Benefit Trust Fund

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 adopted the following broad asset allocation guidelines for the assets managed for RHBT. (Policy targets are established on a market value basis.)

<u>Asset Class</u>	<u>Policy Target</u>
Domestic equity	2.5%
International equity	<u>2.5</u>
Total equity	5.0%
Fixed income	95.0%
Cash (included in fixed income above)	*

*Cash levels to be reviewed as needed, at least annually, collaboratively with management staff from PEIA.

Asset Class Risk Disclosures

Domestic Large Cap Equity Pool

This pool holds equity securities of U.S. companies and money market funds with the highest credit rating. At June 30, 2008, this pool did not hold securities of any one issuer in excess of 5% of the value of the pool in accordance with West Virginia statutes. RHBT's amount invested in the large cap domestic pool of \$5,430,000 at June 30, 2008, represents approximately 0.3% of total investments in this pool.

Domestic Non-Large Cap Equity Pool

This pool holds equity securities of U.S. companies and money market funds with the highest credit rating. At June 30, 2008, this pool did not hold securities of any one issuer in excess of 5% of the value of the pool in accordance with West Virginia statutes. RHBT's amount invested in the non-large cap domestic pool of \$757,000 at June 30, 2008, represents approximately 0.1% of total investments in this pool.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

4. Deposit and Investment Risk Disclosures (continued)

International Equity Pool

At June 30, 2008, this pool did not hold securities of any one issuer in excess of 5.0% of the value of the pool in accordance with West Virginia statutes. This pool has both equity securities and cash that are denominated in foreign currencies and are exposed to foreign currency risks. The amounts (in U.S. dollars) of the securities and cash denominated in foreign currencies are as follows:

Currency	June 30, 2008		
	Equity Securities	Cash	Total
Australian dollar	\$ 56,458,401	\$ 1,147,727	\$ 57,606,128
Brazil cruzeiros real	78,980,550	377,270	79,357,820
British pound	169,390,722	2,625,082	172,015,804
Canadian dollar	87,262,255	1,994,596	89,256,851
Czech Koruna	1,519,907	–	1,519,907
Danish krone	5,533,777	99,697	5,633,474
Euro	338,300,401	1,682,586	339,982,987
Hong Kong dollar	91,548,567	2,012,170	93,560,737
Hungarian forint	18,046,560	182,258	18,228,818
Indian rupee	4,653,903	–	4,653,903
Indonesian rupiah	10,703,375	–	10,703,375
Israeli shekel	11,519,751	54,371	11,574,122
Japanese yen	190,163,595	4,773,663	194,937,258
Malaysian ringgit	10,536,586	1,212,918	11,749,504
Mexican new peso	23,344,620	406,186	23,750,806
New Taiwan dollar	73,448,408	363,885	73,812,293
New Zealand dollar	2,281,221	35,031	2,316,252
Norwegian krone	27,781,461	(707,346)	27,074,115
Pakistani Rupee	2,159,612	–	2,159,612
Philippine peso	2,637,913	–	2,637,913
Polish Zloty	3,909,848	230,158	4,140,006
Singapore dollar	40,965,990	288,581	41,254,571
South African rand	39,201,393	43,223	39,244,616
South Korean won	120,845,929	11,380	120,857,309
Swedish krona	26,805,371	406,838	27,212,209
Swiss franc	67,886,106	1,186,931	69,073,037
Thailand baht	11,858,415	2,244	11,860,659
Turkish Lira	23,039,547	–	23,039,547
Total	\$ 1,540,784,184	\$ 18,429,449	\$ 1,559,213,633

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

4. Deposit and Investment Risk Disclosures (continued)

This table excludes securities held by the pool that are denominated in U.S. dollars. The market value of these U.S. dollar denominated securities is \$131,021,000 at June 30, 2008. RHBT's amount invested in the international equity pool of \$2,374,000 at June 30, 2008, represents approximately 0.14% of total investments in this pool.

Fixed Income Pool

Credit Risk

WVIMB limits the exposure to credit risk in the Fixed Income pool by maintaining at least an average rating of investment grade as defined by the Nationally Recognized Statistical Rating Organizations. Convertible bonds must be rated Baa or higher by Standard & Poor's or BBB or higher by Moody's. The following table provides the weighted-average credit ratings of the asset types in the fixed income pool:

Security Type	June 30, 2008			
	Moody's	S&P	Fair Value	Percent of Assets
Corporate bonds and notes	Baa	BBB	\$ 609,696,835	22.0%
U.S. Treasury bonds and notes	Aaa	AAA	76,318,725	2.7
Corporate asset-backed securities	Aaa	AAA	137,308,217	5.0
Agency mortgage-backed securities	Aaa	AAA	234,846,187	8.5
Agency bonds	Aaa	AAA	5,282,195	0.2
Agency discount notes	P1	A-1	17,537,793	0.6
Money market funds	Aaa	AAA	135,041,247	4.9
Total rated investments			\$ 1,216,031,199	43.9%

At June 30, 2008, unrated securities include commingled investment pools of \$1,549,051,012 swaps, options and swaptions valued at \$(4,248,293), and cash of \$11,984,018 pledged to brokers as collateral. These securities represent 56.1% of the fair value of the pool's investments.

Concentration of Credit Risk

West Virginia statutes prohibit the fixed income pool from investing more than 5% of its assets in securities issued by a single private corporation or association. At June 30, 2008, the fixed income pool did not have investments in any one private corporation or association that represented more than 5% of assets.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

4. Deposit and Investment Risk Disclosures (continued)

Custodial Credit Risk

At June 30, 2008, the fixed income pool held no securities that were subject to custodial credit risk. Repurchase agreements are collateralized at 102% and the collateral is held in the name of the Investment Management Board (IMB). Investments in commingled funds are held in the name of the IMB. All remaining securities are held by the IMB's custodian in the name of the IMB. Securities lending collateral is invested in the lending agent's money market fund.

Interest Rate Risk

WVIMB monitors interest rate risk of the fixed income pool by assessing 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 fixed income pool:

Investment Type	June 30, 2008	
	Fair Value	Modified Duration (years)
Commingled investment pools	\$ 1,549,051,012	3.3
Corporate notes and bonds	609,696,835	6.2
U.S. Treasury notes and bonds	76,318,725	7.9
Corporate asset-backed securities	137,308,217	7.0
Agency mortgage-backed securities	234,846,187	10.8
Agency bonds	5,282,195	8.5
Agency discount notes	17,537,793	0.5
Money market fund	135,041,247	0.0
Total assets	<u>\$ 2,765,082,211</u>	<u>5.4</u>

The 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. At June 30, 2008, the fixed income pool held \$372,154,404 of these securities. This represents approximately 13% of the value of the fixed income pool.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

4. Deposit and Investment Risk Disclosures (continued)

RHBT's amount invested in the fixed income pool of \$118,132,000 at June 30, 2008, represents approximately 4.3% of total investments in this pool.

Foreign Currency Risk

None of the securities held by the fixed income pool are exposed to foreign currency risk. However, the pool does have futures, options, swaps, and foreign exchange futures that are denominated in foreign currencies. Additionally, the pool has indirect exposure to foreign currency risk through its ownership interest in certain of the commingled investment pools. Approximately \$148,326,000, or 10%, of the commingled investment pools hold substantially all of their investments 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, 2008, the WVIMB was in compliance with this limitation.

Fixed Income Nonqualified Pool

This pool holds positions of institutional mutual funds with a combined value of \$474,561,035 at June 30, 2008. The mutual funds invested in mortgage-backed securities and corporate bonds. The mutual funds are unrated. The weighted-average modified duration of the underlying securities is 5.6 years at June 30, 2008. This pool is not exposed to custodial credit risk, concentration of credit risk, or foreign currency risk.

RHBT's amount invested in the fixed income nonqualified pool of \$71,611,000 at June 30, 2008, represents approximately 15.0% of total investments in this pool.

Short-Term Fixed Income Pool

Credit Risk

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 A-1 by Standard & Poor's and P1 by Moody's. Additionally, the pool must have at least 15% of its assets in U.S. Treasury issues.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

4. Deposit and Investment Risk Disclosures (continued)

The following table provides information on the weighted-average credit ratings of the short-term fixed income pool's investments.

Investment Type			June 30, 2008	
	Moody's	S&P	Carrying Value	Percent of Assets
Agency discount notes	P1	A-1	\$ 27,640,155	11.8%
Agency bonds	Aaa	AAA	74,229,589	31.5
U.S. Treasury bills	Aaa	AAA	37,994,460	16.2
Commercial paper	P1	A-1	69,169,330	29.4
U.S. Treasury note	Aaa	AAA	26,096,607	11.1
Money market funds	Aaa	AAA	852	0.0
Total rated investments			\$ 235,130,993	100.0%

This table includes securities received as collateral for repurchase agreements valued at \$76,827,545 for 2008. The amortized cost of the repurchase agreements for 2008 is \$75,621,000.

Concentration of Credit Risk

West Virginia statutes prohibit the pool from investing more than 5% of its assets in securities issued by a single private corporation or association. At June 30, 2008, the pool did not have investments in any one private corporation or association that represented more than 5% of assets.

Custodial Credit Risk

Repurchase agreements are collateralized at 102% and the collateral is held in the name of the WVIMB. Securities lending collateral that is reported in the statement of assets and liabilities is invested in the lending agent's money market fund.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

4. Deposit and Investment Risk Disclosures (continued)

Interest Rate Risk

The WAM of the investments of the short-term fixed income pool cannot exceed 60 days. The maturity of floating rate notes is assumed to be the next interest rate reset date. The following table provides the WAM for the various asset types in the short-term fixed income pool:

	June 30, 2008	
Investment Type	Carrying Value	WAM (days)
Repurchase agreements	\$ 75,621,000	1
U.S. Treasury bills	37,994,460	5
Commercial paper	69,169,330	27
Agency discount notes	27,640,155	51
Agency bonds	23,498,651	35
Money market funds	852	1
Total investments	\$ 233,924,448	19

RHBT's amount invested in the short-term fixed income pool at June 30, 2008 was nominal.

5. Funded Status and Funding Progress

The funded status of the Plan as of the most recent actuarial valuation is as follows (in thousands):

Actuarial Valuation Date	Actuarial Value of Assets (A)	Actuarial Accrued Liability (AAL) – Entry Age (B)	Unfunded AAL (UAAL) (B-A)	Funded Ratio (A/B)	Covered Payroll (C)	UAAL as a Percentage of Covered Payroll [(B-A)/C]
June 30, 2008	\$254,818	\$ 6,362,640	\$ 6,107,822	4.00%	\$ 3,298,252	185.18%
June 30, 2007	\$ 3,167	\$ 3,679,933	\$ 3,076,766	0.10%	\$ 3,312,102	92.89%

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

5. Funded Status and Funding Progress (continued)

The increase in the estimated Actuarial Accrued Liability (AAL) at June 30, 2007, is primarily due to two factors. The change in capitation rates and trend assumptions due to changes in the MAPD capitation rates increased the AAL by approximately \$1.2 billion. Further, the change in the discount rate from 5.22% to 3.72% based on the change in market conditions to increase by approximately \$1.6 billion.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the health care cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The estimated actuarial accrued liability reflected above is based on the substantive plan in place at the time of the latest actuarial valuation. Accordingly, it reflects the impact of transferring Medicare covered participants to the MAPD plan. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. The purpose of the disclosure is to provide information that approximates the funding progress of the plan.

The accompanying schedule of employer contributions, also presented as required supplementary information, presents trend information about the amounts contributed to the plan by employers in comparison to the amount that is actuarially determined in accordance with the parameters of GASB Statement No. 43 (the ARC). The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

West Virginia Retiree Health Benefit Trust Fund

Notes to Financial Statements (continued)

5. Funded Status and Funding Progress (continued)

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. However, the preparation of any estimate of future postretirement costs requires consideration of a broad array of complex social and economic events. Future changes in the Medicare Advantage Prescription drug program, changes in reimbursement methodology, the emergence of new and expensive medical procedures and prescription drugs option, changes in the investment rate of return, and other matters increase the level of uncertainty of such estimates. As such, the estimate of postretirement program costs contains considerable uncertainty and variability and actual experience may vary significantly by the current estimated obligation. Additional information for the latest actuarial valuations follows:

	Valuation Date	
	June 30, 2008	June 30, 2007
Actuarial cost method	Entry age	Entry age
Amortization method	Level percentage of projected payroll, closed	Level percentage of projected payroll, closed
Remaining amortization period	28 years	29 years
Asset valuation method	Fair value	Fair value
Actuarial assumptions:		
Investment rate of return	3.72% blended rate reflecting long-term expected returns on RHBT and State investments	5.22% blended rate reflecting long-term expected returns on RHBT and State investments
Health care cost trend rate	9.2% initial; 6.0% ultimate	8.9% initial; 6.0% ultimate

West Virginia Retiree Health Benefit Trust Fund

Schedule of Funding Progress (Unaudited)

(In Thousands)

Actuarial Valuation Date	Actuarial Value of Assets (A)	Actuarial Accrued Liability (AAL) – Entry Age (B)	Unfunded AAL (UAAL) (B-A)	Funded Ratio (A/B)	Covered Payroll (C)	UAAL as a Percentage of Covered Payroll [(B-A)/C]
June 30, 2008	\$ 254,818	\$ 6,362,640	\$ 6,107,822	4.00%	\$ 3,298,252	185.18%
June 30, 2007	\$ 3,167	\$ 3,079,933	\$ 3,076,766	0.10%	\$ 3,312,102	92.89%

The actuarial methods and assumptions used in estimating the information included in the schedule of funding progress are as follows:

Valuation date	June 30, 2008	June 30, 2007
Actuarial cost method	Entry age	Entry age
Amortization method	Level percentage of projected payroll, closed	Level percentage of projected payroll, closed
Remaining amortization period	28 years	29 years
Asset valuation method	Fair value	Fair value
Actuarial assumptions:		
Investment rate of return	3.72% blended rate reflecting long-term expected returns on RHBT and State investments	5.22% blended rate reflecting long-term expected returns on RHBT and State investments
Health care cost trend rate	9.2% initial; 6.0% ultimate	8.9% initial; 6.0% ultimate

The estimated actuarial accrued liability reflected above is based on the substantive plan in place at the time of the latest actuarial valuation. Accordingly, it reflects the impact of transferring Medicare covered participants to a Medicare Advantage Prescription Drug (MAPD) plan. The total population covered by the RHBT was approximately 106,578 and 106,391 at June 30, 2008 and 2007, respectively.

West Virginia Retiree Health Benefit Trust Fund
 Schedule of Employer Contributions (Unaudited)

(In Thousands)

Year Ended June 30	Annual Required Contribution	Percentage Contributed
2008	\$ 397,975	81%
2007	649,426 (1)	19%

- (1) The annual required contribution (ARC) for the year ended June 30, 2007, does not reflect the impact of transferring Medicare plan participants to a MAPD and other substantive plan changes that were made subsequent to the 2008 ARC calculation.

Required Supplementary Information

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 Board of Directors of the West Virginia
Retiree Health Benefit Trust Fund

We have audited the financial statements of the West Virginia Retiree Health Benefit Trust Fund (RHBT) as of and for the year ended June 30, 2008, and have issued our report thereon dated March 23, 2009. 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 RHBT'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 RHBT's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of RHBT's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of findings as items 2007-01, 2007-02, and 2007-03 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 2007-1 and 2007-2 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether RHBT'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*.

RHBT's responses to the findings identified in our audit are described in the accompanying schedule of findings. We did not audit the West Virginia Retiree Health Benefit Trust Fund's responses and, accordingly, we express no opinion on them.

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

March 23, 2009

STATE OF WEST VIRGINIA SCHEDULE OF FINDINGS

2008–1 INFORMATION SYSTEM CONTROLS

State Agency

Public Employees Insurance Agency (PEIA) and Retiree
Health Benefit Trust (RHBT)

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

Condition: BAS and Great Plains (implemented during fiscal year 2008) applications:

- Manage Changes – Authorization, Testing, and Approval

During our 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 before migration to the production environment.

- Manage Changes – OS and DB Upgrades/Patches

The process for applying operating system (OS) and database (DB) upgrades and/or patches (for the BAS and Great Plains applications) 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.

- Logical Access – User Access Administration, Periodic Review

A periodic review of user access for the Great Plains and BAS applications is not being performed to ensure user access rights correspond to user job responsibilities.

Additionally, during our review of terminated employees, we identified one employee who left PEIA and assumed a position within the Office of Technology; however his access to Great Plains at PEIA was not removed. PEIA management indicated that the access is no longer required as part of his job responsibilities.

- Logical Access – Password Settings

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.

STATE OF WEST VIRGINIA SCHEDULE OF FINDINGS

2008-1 INFORMATION SYSTEM CONTROLS

(continued)

State Agency

Public Employees Insurance Agency (PEIA) and Retiree
Health Benefit Trust (RHBT)

- Logical Access – Administrator Access

There is one user ID (assigned to a Microsoft Consultant) that is currently assigned to a blank user class which allows the ID full rights within the application. The combination of duties represents a potential segregation of duties conflict within the Great Plains logical access environment.

Access to the default Windows ‘administrator’ ID on the ‘PEIAGPPROC01’, ‘PEIAGPSQL01’, and ‘PEIAGPBIZTALK01’ production servers (that support the Great Plains applications) is not appropriately restricted. This ID is being shared and the password is not periodically changed.

Additionally, the ‘SA’ and ‘DYNSA’ accounts on the production SQL database (‘DB01’) that supports the Great Plains application are not appropriately restricted. These IDs are being shared and the passwords are not periodically changed.

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

Cause: During the time of our review, development was still in process and programmers were still actively working on the new system. Accordingly, management indicated that they had not had time to develop and implement certain IT procedures and controls.

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.

STATE OF WEST VIRGINIA SCHEDULE OF FINDINGS

2008-1 INFORMATION SYSTEM CONTROLS

(continued)

State Agency

Public Employees Insurance Agency (PEIA) and Retiree
Health Benefit Trust (RHBT)

- Logical Access – User Access Administration, Periodic Review

Inadequate access administration controls can lead to unauthorized and/or inappropriate access to sensitive information.

- Logical Access – Password Settings

The current password settings could lead to unauthorized access to sensitive and/or confidential information.

- Logical Access – Administrator Access

The current administrator access structure could lead to inappropriate or excessive user access rights being granted to existing users. The ability for the user to bypass established processes and controls can lead to inappropriate access to sensitive information.

Recommendation:

- Management should consider implementing formal policies and procedures surrounding Great Plains and BAS program changes (modifications or upgrades) to include documentation of authorization, testing, and approval.
- Management should also consider implementing formal policies and procedures surrounding the upgrades and/or patches applied to the operating system and database upgrades supporting the BAS and Great Plains applications.
- Management should enhance the current application access administration processes to ensure that reviews of user access are performed on a periodic basis (i.e., annually) to ensure user access rights remain consistent with user job responsibilities. Review procedures should be performed for all users with access to the applications. In addition, management should ensure that adequate documentation is maintained to provide evidence (sign-offs, hard-copy reports, etc.) of the review.
- 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.
- Management, within the Great Plains application, should verify that all user IDs belong to a defined user class in the application and correspond to their job responsibilities.

**STATE OF WEST VIRGINIA
SCHEDULE OF FINDINGS**

2008-1 INFORMATION SYSTEM CONTROLS

(continued)

State Agency

Public Employees Insurance Agency (PEIA) and Retiree
Health Benefit Trust (RHBT)

- Management should restrict access to the privileged default IDs (for each operating system server and database) and limit them to a select number of IT personnel. The password for these IDs should be changed periodically to inhibit unauthorized users from accessing the accounts.

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

PEIA is actively participating with the West Virginia Office of Technology (OOT) and Microsoft Consulting Services to respond to these findings by implementing the recommendations. The issues of access and change are already significantly reduced. The Great Plains user ID assigned to a blank class has been resolved. OOT has been made aware of our need for formal policies and has assigned this responsibility to top management within their agency to assist PEIA in resolving the issues.

With OOT assistance, management will be developing policies for access and changes. Access will be formally approved and monitored with regular reviews of individual access levels. All changes will be reviewed by management before allowing access to production data by OOT.

STATE OF WEST VIRGINIA SCHEDULE OF FINDINGS

2008–2 NEW SYSTEM IMPLEMENTATION AND OTHER MATTERS

State Agency

Public Employees Insurance Agency (PEIA) and Retiree
Health Benefit Trust (RHBT)

Criteria: A critical element of an entity's internal control is its ability to record, process, and summarize accounting transactions in a timely manner and to prepare financial reports that give a true and accurate assessment of the entity's financial status. Timely, accurate financial information is crucial to effective decision-making by management..

Further, a fundamental concept of effective internal control is supervision and review of general ledger activities, including journal entries.

Condition: During fiscal year 2008, PEIA management implemented a new information system that is utilized in accounting and financial reporting for PEIA and RHBT. Management encountered significant accounting and reporting issues while implementing the new system including the following:

- Significant delays in being able to produce reliable PEIA and RHBT financial statements.
- Several accounts, including cash, were not properly reconciled in a timely manner, resulting in significant adjustments upon completion of the reconciliations. Furthermore, no procedures are in place requiring the reconciliation of the online portal information in the new system with the GP national account. Consequently, we noted certain instances where transactions were posted at the GP level but not reflected in the portal.
- Significant issues were noted in the premium billing and collection process as employers and PEIA personnel went through the learning curve of understanding the complexity of the new system. Consequently, significant PEIA staff time was spent reconciling employer account balances, including the split between PEIA and RHBT amounts due.
- Employers' payments in excess of \$14,217,836 were held as of June 30 and not deposited in a timely manner. This resulted in significant delays and inefficiencies in reconciling participating employer account balances. Additionally, instances were noted where the held check amount was not properly allocated between PEIA and RHBT.
- Delays in accurately reporting the due to/from RHBT balance (i.e., certain RHBT cash was deposited in PEIA cash accounts at June 30 in error).
- Management originally allocated certain general revenue fund appropriations in one manner; however, the legislative budget bill was later revised to clarify such appropriations should be made only to general revenue fund FTEs. Upon review of the allocation methodology, we noted that the reallocation still had not been appropriately reflected at the individual account level. Management is still in process of making the necessary correcting entries at the account level.

STATE OF WEST VIRGINIA SCHEDULE OF FINDINGS

2008–2 NEW SYSTEM IMPLEMENTATION AND OTHER MATTERS (continued)

State Agency

Public Employees Insurance Agency (PEIA) and Retiree
Health Benefit Trust (RHBT)

- Further, we noted that various individuals including the IT programmer, controller, and other accountants create and post journal entries in the general ledger without supervisory review and approval of entries. Further, we noted instances where supporting documentation was not maintained to support certain journal entries.

Context: Management was not able to produce accurate financial statements for PEIA and RHBT until February 2009.

Cause: Management indicated that problems were encountered in the new system conversion process, including the unanticipated learning curve time for PEIA and employer personnel to understand and effectively utilize the new system. Furthermore, the individual primarily responsible for RHBT accounting left during the new system implementation process.

The current procedures do not require journal entries to be reviewed and approved. Nor is documentation required to be retained to support entries that are made.

Effect: Management was unable to provide financial statements to executive management and the Finance Board in a timely manner.

Without proper review and approval of journal entries, errors or irregularities could occur and not be detected.

Recommendation: Management has spent a significant amount of time to date in fiscal year 2009 focused on cleaning up fiscal year 2008 information. Consequently, sufficient resources should be devoted to refining the fiscal year 2009 information to date and in the future to ensure that accurate timely financial statements are produced prospectively. As part of this process, all accounts should be reconciled in a timely manner. Furthermore, management should evaluate the root cause of the system issues encountered and determine the necessary corrective action to prevent their reoccurrence (i.e., additional training, hiring additional staff, new policies and procedures). For instance, procedures should be established requiring the reconciliation of the online portal information with the GP national account level information. Additionally, procedures should be formalized to address how general revenue fund appropriations are supposed to be allocated to ensure consistency in the process and avoid potential disputes among the participating employers. Management should also implement their procedures to follow up on and resolve participant credit balances in a timely manner.

With the new system, management has the ability to generate premiums/contributions aging reports and collection history. Accordingly, we recommend that management challenge the methodology for estimating the allowance for doubtful accounts and begin using actual collection history by aging category based on hindsight analysis to determine the allowance percentage by aging category.

**STATE OF WEST VIRGINIA
SCHEDULE OF FINDINGS**

**2008–2 NEW SYSTEM IMPLEMENTATION AND OTHER MATTERS
(continued)**

State Agency

Public Employees Insurance Agency (PEIA) and Retiree
Health Benefit Trust (RHBT)

Policies and procedures should be developed requiring limiting the individuals that have the ability to create and post journal entries in the general ledger. In particular, IT personnel should not have the ability to make journal entries. Additionally, the policies and procedures should require that journal entries be reviewed and approved by supervisory personnel and documentation be maintained supporting the entries.

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

Management agrees with the recommendations and will begin development of the recommendations immediately. Cash reconciliations for fiscal year 2009 have begun and many of the issues that caused the conditions within this finding have already been resolved. We are also currently attempting to create and fill a Controller position for the RHBT. Additional training and familiarity of our systems has also significantly reduced the conditions mentioned above.

Management believes that the implementation of GASB 45 by the State and the splitting of premiums into PEIA and RHBT to provide a clearer reporting of the two agencies' accounting transactions created significant confusion of users in addition to the implementation of the new system.

Many of the cash deposit errors were caused by users external to PEIA via intergovernmental transfers through the West Virginia Financial Information Management System. Training and familiarity of the new system and the multiple agency format is reducing such errors.

Management could not control the fact that the fiscal year 2008 budget bill was changed during a special session on June 28, 2008, to redefine how the general revenue appropriation into RHBT was to be allocated. However, management will continue to develop procedures that may mitigate the effects of such a reoccurrence.

STATE OF WEST VIRGINIA SCHEDULE OF FINDINGS

2008–3 POSTEMPLOYMENT OBLIGATION (OPEB) (Prior Year Finding 2007–7)

State Agency

Department of Administration and Retiree Health Benefit
Trust (RHBT)

Criteria: GASB 43, Financial Reporting for Postemployment Benefits other Than Pensions, and GASB 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, require that a new actuarial valuation be performed if significant changes have occurred since the last valuation, including significant changes in benefit provisions, size or composition of membership, or other factors impacting actuarial assumptions. The actuarial valuation should be based on the substantive plan in place (changes in plan terms that have been made and communicated to plan members) at the time of the valuation. The time of the valuation refers to the time when the actuary is performing the valuation. The reliability of the actuarial estimate, including actuarial assumptions, is dependent on the reliability of the data utilized by the actuaries in completing their valuation.

Condition: The West Virginia Retiree Health Benefit Trust (RHBT) actuarial valuation is based on data provided by various State data sources, including information provided by RHBT, West Virginia Public Employees Insurance Agency (PEIA), West Virginia Consolidated Public Retirement Board (CPRB), and the Department of Administration (DOA). This data utilized by the actuaries in developing key actuarial assumptions including pension vs. health insurance conversion ratio, retirement rate percentage, and expected conversion rate percentage, has a significant impact on the estimated actuarial accrued liability and the related annual required contribution (ARC). In conjunction with our current year audit, we noted that management had not updated and maintained documentation supporting the reasonableness of the key assumptions utilized in the estimation process in a timely manner. Further, there are no formal procedures in place to address the accounting for key matters in the Other Postemployment Benefit (OPEB) administration process including:

- The timing of the actuarial valuation date and linkage with the employer's reporting period.
- Handling of changes in the underlying participant members used in the original ARC allocation among participating employers.
- Handling of PEIA excess reserve transfers to RHBT, State appropriations, credits, on-behalf payments, etc., including documentation of which employers receive credits for the different items.

In addition, a significant component utilized in the calculation is the information derived from the overall State sick leave and annual leave data warehouse database. This database includes information submitted by each agency relating to sick and annual leave. However, not all agencies report their information through this warehouse; therefore, the actuary is required to make assumptions and estimate various inputs into the total sick leave days, which serves as the base, for the conversion of such days to OPEB. Currently, the State does not have controls in place to ensure the overall data integrity of the sick and annual leave data warehouse.

**STATE OF WEST VIRGINIA
SCHEDULE OF FINDINGS**

**2008–3 POSTEMPLOYMENT OBLIGATION (OPEB)
(Prior Year Finding 2007–7) (continued)**

State Agency
Department of Administration and Retiree Health Benefit
Trust (RHBT)

- Context:** The estimated actuarial accrued liability as of June 30, 2008, was \$6.3 billion.
- Cause:** The State does not have formalized policies and procedures over the OPEB estimation process in place.
- Effect:** The amounts recorded by management may not reflect the best estimate of the OPEB obligation.
- Recommendation:** The key assumptions utilized in the postemployment obligation estimation process should be challenged on an annual basis and a new valuation should be completed if significant changes have occurred since the last valuation. Further, supporting documentation should be retained to support the assumptions utilized in the actuarial valuation. Further, this process needs to take place to provide the State and other employers' sufficient lead time between the calculation of the ARC and the employer's budgeting process, so that the employers can incorporate the ARC into their budgets. The linkage between a particular valuation date and the employer reporting periods should be established and formalized by an accounting policy decision on behalf of the employers in conjunction with PEIA, who has administrative responsibility for RHBT. Furthermore, formal policies should be established to address other matters involved in the OPEB administration process including changes in the ARC participant base, handling of State appropriations, PEIA excess reserve transfers, credits and on-behalf payments, etc.

Management should follow up on the known data discrepancies and work with the other agencies involved in the process to implement quality control review procedures to ensure that future data provided to the actuary is complete and accurate. Further, documentation should be maintained to support the data relied upon by the actuaries in developing their assumptions (i.e., sick and annual leave conversion %) and estimating the actuarial accrued obligation and related ARC. In particular, management should work with the State financial and accounting reporting unit to determine what State agency should assume overall responsibility for the sick and annual leave warehouse information. Policies and procedures should be established to ensure consistent and accurate reporting of sick and annual leave data by all covered entities, including establishing policies for gathering the data from the various entities that currently do not report their information to the data warehouse.

Improving the reliability of the data used by the actuaries and the timeliness of the actuarial valuations, should help to refine the future estimates of the actuarial accrued liability and related ARCs made by the actuaries.

**STATE OF WEST VIRGINIA
SCHEDULE OF FINDINGS**

**2008-3 POSTEMPLOYMENT OBLIGATION (OPEB)
(Prior Year Finding 2007-7) (continued)**

State Agency
Department of Administration and Retiree Health Benefit
Trust (RHBT)

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

Management has reviewed the finding and concurs. Management will continue to attempt to define and refine the policies and procedures regarding administration of the West Virginia OPEB Plan that are within its control. Future actuarial valuations will be secured in a timely manner and supporting documentation underlying the data and assumptions utilized by the actuaries in developing their actuarial estimates will be maintained. Management is currently attempting to fill the Controller position at the RHBT.

Management will seek to have the responsibility for the leave data warehouse formally appointed. Additionally, we will work with the State Financial Accounting and Reporting Section (FARS) to ensure that the State agency with the designated responsibility for the data warehouse develops and implements appropriate policies and procedures to ensure the integrity of the data.

Further, now that there is a much broader base understanding of OPEB, more agencies are now willing to discuss the administrative aspects with RHBT. This should provide efficiencies such as including the supplemental appropriations in each agency's appropriation and specific instructions on the payment of the obligation.