

**BLACK HILLS EDUCATIONAL  
BENEFITS COOPERATIVE**

**FINANCIAL STATEMENTS**

**JUNE 30, 2016 AND 2015**



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
JUNE 30, 2016 AND 2015

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**INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors  
Black Hills Educational Benefits Cooperative  
Sturgis, South Dakota

**Report on the Financial Statements**

We have audited the accompanying financial statements of Black Hills Educational Benefits Cooperative, (the Cooperative) (a public entity risk pool) as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Cooperative'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 accounting principles generally accepted in the United States of America; 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.

**Auditor's Responsibility**

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 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 auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether

## INDEPENDENT AUDITOR'S REPORT (CONTINUED)

due to fraud or error. In making those risk assessments, the auditor considers internal control 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 opinions.

### **Opinions**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Black Hills Educational Benefits Cooperative, as of June 30, 2016 and 2015, and the respective changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### **Other Matters**

#### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 7 through 10 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.



## INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

Management has omitted certain revenue and claims development information that governmental accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated December 15, 2016 on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Cooperative's internal control over financial reporting and compliance.

*David Pummel & Associates, LLP*

Belle Fourche, South Dakota  
December 15, 2016





INDEPENDENT AUDITOR'S 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*

To the Board of Directors  
Black Hills Educational Benefits Cooperative  
Sturgis, South Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Black Hills Educational Benefits Cooperative, (the Cooperative) (a public entity risk pool) as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which comprise the basic financial statements, and have issued our report thereon dated December 15, 2016.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Cooperative's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control.

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

INDEPENDENT AUDITOR'S 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 (CONTINUED)

deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a certain deficiency in internal control described in the accompanying schedule of findings and questioned costs as item 2016-1 that we consider to be a significant deficiency.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts, 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 one instance of noncompliance that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings as item 2016-2.

#### Cooperative's Response to Findings

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



INDEPENDENT AUDITOR'S 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* (CONCLUDED)

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, as required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.

*David Pummel & Associates, LLP*

Belle Fourche, South Dakota  
December 15, 2016





**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE**  
**MANAGEMENT DISCUSSION AND ANALYSIS**  
**JUNE 30, 2016**

This section of Black Hills Educational Benefits Cooperative's (BHEBC) annual financial report presents discussion and analysis of BHEBC's financial performance during the fiscal year ended on June 30, 2016. Please read it in conjunction with BHEBC's financial statements, which follow this section.

**FINANCIAL HIGHLIGHTS**

- BHEBC's net position increased \$988,280; cash increased 52.99%, while investments increased 18.65%.
- During the year, BHEBC's revenues generated from contributions and investment income were \$988,280 more than the \$4,257,949 in expenditures.
- The total cost of BHEBC's programs increased by 7.41% which was due to an increase in premiums paid, net claims paid, administration fees, and professional fees.
- The proprietary fund reported a \$988,280 current year surplus due to the increase in contributions and an increase in investment income.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This annual report consists of two parts - management's discussion and analysis (this section) and the basic financial statements.

Proprietary fund statements offer short and long-term financial information about the activities that BHEBC operates like a business.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

**Fund Financial Statements**

The fund financial statements provide more detailed information about BHEBC's one fund. Funds are accounting devices used to keep track of specific sources of funding and spending for particular purposes. Fund accounting is required by South Dakota State Law.

BHEBC's operations fall under the Proprietary Fund type.

Proprietary Fund - Services for which BHEBC charges a fee are reported in a proprietary fund. The insurance fund is the only fund maintained by BHEBC.



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

JUNE 30, 2016

FINANCIAL ANALYSIS OF BHEBC AS A WHOLE

Net Position

BHEBC's combined statement of net position increased as follows:

Table A-1  
Black Hills Educational Benefits Cooperative  
Statement of Net Position

	Proprietary Fund Activities <u>FY 2016</u>	Proprietary Fund Activities <u>FY 2015</u>
Current Assets	<u>\$ 5,225,176</u>	<u>\$ 4,166,339</u>
<b>Total Assets</b>	<u>\$ 5,225,176</u>	<u>\$ 4,166,339</u>
Current Liabilities	<u>\$ 448,025</u>	<u>\$ 377,468</u>
<b>Total Liabilities</b>	<u>\$ 448,025</u>	<u>\$ 377,468</u>
Unrestricted Net Position	<u>\$ 4,777,151</u>	<u>\$ 3,788,871</u>
<b>Total Net Position</b>	<u>\$ 4,777,151</u>	<u>\$ 3,788,871</u>
Beginning Net Position	<u>\$ 3,788,871</u>	<u>\$ 2,635,763</u>
Change in Net Position	<u>\$ 988,280</u>	<u>\$ 1,153,108</u>
Percentage of Increase (Decrease) in Net Position	<u>26.08%</u>	<u>43.75%</u>

The Statement of Net Position reports all financial and capital resources. The Statement presents the assets and liabilities in order of relative liquidity. The liabilities of BHEBC, consisting of claims incurred but not paid, have been reported in this same manner on the Statement of Net Assets. The difference between BHEBC's assets and liabilities is its net position.

Changes in Net Assets

BHEBC's revenues totaled \$5,246,229. (See Table A-2.) Most of BHEBC's revenue comes from Other Revenue - Local Sources i.e. contributions from member districts. BHEBC's expenses cover support services, which include board services, fiscal services; and non-programmed charges, which include reinsurance, claims, claims services, claims administration services and ACA fees.



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)  
JUNE 30, 2016

BUSINESS-TYPE ACTIVITIES

Table A-2 also considers the operations of the business-type activities.

Revenues from BHEBC's business-type activities increased by 2.52% to \$5,246,229 and expenses increased by 7.41% to \$4,257,949. Factors contributing to these changes include:

- Revenues increased because of an increase in investment income and an increase in contributions from the prior year.
- The primary reason for the increase in expenses is a 6.83% increase in premiums paid, a 5.22% increase in net claims paid, a 34.89% increase in the administration fees, and a 79.69% increase in professional services. The significant increase in professional fees is attributed to the actuarial study that was required for one of the districts.
- The increase in contribution income correlated to the increase in contribution rates. Enrollment continues to remain relatively stable.

Table A-2  
Black Hills Educational Benefits Cooperative  
Changes in Net Position

	Total Proprietary Fund Activities FY 2016	Total Proprietary Fund Activities FY 2015
<b>Revenues</b>		
Earnings from		
Investments & Deposits	\$ 216,091	\$ 96,837
Other Revenue - Local		
Sources	<u>5,030,138</u>	<u>5,020,369</u>
Total Revenues	<u>5,246,229</u>	<u>5,117,206</u>
<b>Expenses</b>		
Support Services	9,380	10,742
Non-Programmed Charges	<u>4,248,569</u>	<u>3,953,356</u>
Total Expenses	<u>4,257,949</u>	<u>3,964,098</u>
Increase (Decrease) in Net Position	<u>\$ 988,280</u>	<u>\$ 1,153,108</u>
Ending Net Position	<u>\$ 4,777,151</u>	<u>\$ 3,788,871</u>



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
MANAGEMENT DISCUSSION AND ANALYSIS (CONCLUDED)  
JUNE 30, 2016

**FINANCIAL ANALYSIS OF BHEBC'S FUND**

The Proprietary Funds increased \$988,280 this year. Future reinsurance, administration fees and claim increases will be covered by increased contributions and reserves.

**BUDGETARY HIGHLIGHTS**

The Board approves a preliminary budget in May and adopts the final budget in August.

**CAPITAL ASSET ADMINISTRATION**

BHEBC has not acquired any capital assets.

**LONG-TERM DEBT**

BHEBC has not and cannot incur any long-term debt.

**ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES**

BHEBC's current economic position has seen an increase in fund balance. This increase can be attributed to the increase in contributions of 1.31 percent. The overall budget for next year increased slightly. A budgeted increase in projected net claims and professional services will be covered by a slight increase in the single contribution rates and an even greater increase in the family contribution rate.

**CONTACTING BHEBC'S FINANCIAL MANAGEMENT**

This financial report is designed to provide citizens, taxpayers, customers, investors and creditors with a general overview of BHEBC's finances and to demonstrate BHEBC's accountability for the money it receives. If you have questions about this report or need additional information, contact Black Hills Special Services Cooperative's Business Office, P.O. Box 218, Sturgis, SD 57785.



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
 STATEMENTS OF NET POSITION  
 JUNE 30, 2016 AND 2015

	<u>2016</u>	<u>2015</u>
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 1,265,983	\$ 827,468
Accounts receivable	39,396	34,846
Prepaid insurance	852	1,080
Investments	<u>3,918,945</u>	<u>3,302,945</u>
<b>TOTAL CURRENT ASSETS</b>	<u>\$ 5,225,176</u>	<u>\$ 4,166,339</u>
 <b>CURRENT LIABILITIES</b>		
Fees payable	\$ 86,273	\$ 79,860
Claims incurred but not reported	<u>361,752</u>	<u>297,608</u>
<b>TOTAL CURRENT LIABILITIES</b>	<u>448,025</u>	<u>377,468</u>
 <b>NET POSITION - UNRESTRICTED</b>	 <u>4,777,151</u>	 <u>3,788,871</u>
 <b>TOTAL CURRENT LIABILITIES AND NET POSITION</b>	 <u>\$ 5,225,176</u>	 <u>\$ 4,166,339</u>

See accompanying notes.



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
 STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET POSITION  
 FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	2016	2015
<b>OPERATING REVENUE</b>		
Premiums	\$ 5,030,138	\$ 5,020,369
<b>OPERATING EXPENSE</b>		
Advertising	680	705
Administration	311,617	231,016
Claims	3,106,307	2,952,259
Directors' fees	2,700	2,775
Insurance premiums	817,541	764,080
Professional fees	19,050	13,263
Supplies	54	--
	4,257,949	3,964,098
<b>OPERATING INCOME (LOSS)</b>	772,189	1,056,271
<b>NONOPERATING REVENUE (EXPENSE)</b>		
Investment income	121,252	95,768
Net realized gain (loss) on investments	10,263	922
Net unrealized gain (loss) on investments	84,576	147
	216,091	96,837
<b>INCREASE IN NET POSITION</b>	988,280	1,153,108
<b>NET POSITION - BEGINNING OF YEAR</b>	3,788,871	2,635,763
<b>NET POSITION - END OF YEAR</b>	\$ 4,777,151	\$ 3,788,871

See accompanying notes.



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash receipts from participants	\$ 5,021,341	\$ 5,037,976
Claims paid	( 3,038,230)	( 2,981,222)
Cash payments for insurance	( 816,017)	( 763,684)
Cash payments for administration	( 306,186)	( 214,162)
Other operating cash payments	( 22,484)	( 16,430)
<b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	<b>838,424</b>	<b>1,062,478</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sale of investments	2,367,613	280,740
Purchase of investments	( 2,888,774)	( 1,176,431)
Investment income	121,252	95,768
<b>NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>	<b>( 399,909)</b>	<b>( 799,923)</b>
<b>NET INCREASE (DECREASE) IN CASH</b>	438,515	262,555
<b>CASH - BEGINNING OF YEAR</b>	827,468	564,913
<b>CASH - END OF YEAR</b>	<b>\$ 1,265,983</b>	<b>\$ 827,468</b>
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
Operating income (loss)	\$ 772,189	\$ 1,056,271
Adjustments to reconcile operating loss to net cash provided by operating activities		
Decrease (increase) in		
Accounts receivable	( 4,550)	25,162
Prepaid insurance	228	396
Increase (decrease) in		
Claims payable	64,143	( 36,518)
Fees payable	6,414	17,167
<b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	<b>\$ 838,424</b>	<b>\$ 1,062,478</b>

See accompanying notes.



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF THE COOPERATIVE AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of the Cooperative

The Black Hills Educational Benefits Cooperative (the Cooperative) is a public entity risk pool organized as a cooperative education service unit, comprised of member public entities. The Cooperative was organized July 1, 1996 to provide employee health benefit services to employees of member public entities through a partially self-funded plan. Risk is assumed by Black Hills Educational Benefits Cooperative. Member public entities are not liable for claims in excess of Cooperative assets. The goal of the Cooperative is to assist participating member public entities in providing appropriate benefits for all employees and families on a cooperative basis, services that these public entities would not be able to provide as effectively or as economically acting alone. Public entities seeking membership must be approved by an affirmative vote of a majority of the members of the Board of Directors. Any member entity may withdraw from the Cooperative by action of its Board of Directors. Withdrawal notice shall be made prior to February 1 for the succeeding school year. The Board of Directors can raise premiums or commit participating entities to obligations beyond the membership period. The Cooperative cannot enter into any long-term debt. A third party administrator is selected to administer all claims and secure reinsurance and other insurance coverage. Plan members currently are Black Hills Special Services Cooperative, New Underwood School District 51-3, Wall School District 51-5, Custer School District 16-1, Oelrichs School District 23-3, and Belle Fourche School District 9-1.

Summary of Significant Accounting Policies

1. Basis of Accounting

The Cooperative is a government entity comprised of one enterprise fund which uses the accrual basis of accounting for financial statement purposes. Revenues are recognized in the period in which they become due. Expenses are recognized in the period in which the related liability is incurred.





BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF THE COOPERATIVE AND SUMMARY OF SIGNIFICANT  
ACCOUNTING POLICIES (CONTINUED)

2. Deposits and Investments - Credit Risk, Concentrations of  
Credit Risk and Interest Rate Risk

Various restrictions on deposits and investments are imposed by statutes. These restrictions are summarized below:

Deposits - The Cooperative's deposits are made in qualified public depositories as defined by SDCL 4-6A-1, 13-16-15, 13-16-15.1 and 13-16-18.1. Qualified depositories are required by SDCL 4-6A-3 to maintain at all times, segregated from their other assets, eligible collateral having a value equal to at least 100 percent of the public deposit accounts which exceed deposit insurance such as the FDIC and NCUA. In lieu of pledging eligible securities, a qualified public depository may furnish irrevocable standby letters of credit issued by federal home loan banks accompanied by written evidence of that bank's public debt rating which may not be less than "AA" or a qualified public depository may furnish a corporate surety bond of a corporation authorized to do business in South Dakota.

Investments - In general, SDCL 4-5-6 permits Cooperative funds to be invested in (a) securities of the United States and securities guaranteed by the United States government either directly or indirectly; or (b) repurchase agreements fully collateralized by securities described in (a) above; or in shares of an open-end, no-load mutual fund administered by an investment company whose investments are in securities described in (a) above; and repurchase agreements described in (b) above. Also, SDCL 4-5-9 requires investments to be in the physical custody of the political subdivision or may be deposited in a safekeeping account with any bank or trust company designated by the political subdivision as its fiscal agent.

Fair Value Measurement - The Cooperative categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF THE COOPERATIVE AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

The Cooperative has the following recurring fair value measurements as of June 30, 2016.

		<u>Fair Value Measurements Using</u>		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	\$ 322,119	\$ 322,119	\$ --	\$ --
Certificates of deposit	1,654,422	--	1,654,422	--
Agency bonds	1,645,422	--	1,645,422	--
Collateralized mortgage obligations	296,982	--	296,982	--
	<u>\$ 3,918,945</u>	<u>\$ 322,119</u>	<u>\$ 3,596,826</u>	<u>\$ --</u>

Credit Risk - State law limits eligible investments for the Cooperative, as discussed above. The Cooperative has no investment policy that would further limit its investment choices.



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF THE COOPERATIVE AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2. Deposits and Investments - Credit Risk, Concentrations of Credit Risk and Interest Rate Risk (continued)

The Cooperative had the following investments at June 30, 2016 and 2015. All investments are in an internal deposit and investment pool.

	Credit Rating	2016 Market Value	2015 Market Value
Government National Mortgage Assn Real Estate Mortgage Investment Conduits	Not Rated	\$ 8,640	\$ 10,647
Federal National Mortgage Assn Notes	AAA	501,270	508,598
Real Estate Mortgage Investment Conduits	Not Rated	1,197	1,457
Federal Home Loan Mortgage Corp Notes	AAA	315,136	481,866
Real Estate Mortgage Investment Conduits/Collateral Mortgage Obligations	Not Rated	287,145	339,971
Federal Farm Credit Bank Notes	AAA	386,520	185,557
Federal Home Loan Bank Notes	AAA	442,496	733,107
Total Investments		<u>\$ 1,942,404</u>	<u>\$ 2,261,203</u>

As of June 30, 2016, the Coop had the following maturities of investments:

	Fair Value	Investment Maturities (in years)	
		Less Than 10	More Than 10
Government National Mortgage Assn Real Estate Mortgage Investment Conduits	\$ 8,640	\$ --	\$ 8,640
Federal National Mortgage Assn Notes	501,270	255,936	245,334
Real Estate Mortgage Investment Conduits	1,197	--	1,197
Federal Home Loan Mortgage Corp Notes	315,136	315,136	--
Real Estate Mortgage Investment Conduits/Collateral Mortgage Obligations	287,145	--	287,145
Federal Farm Credit Bank Notes	386,520	85,230	301,290
Federal Home Loan Bank Notes	442,496	10,000	432,496
	<u>\$ 1,942,404</u>	<u>\$ 666,302</u>	<u>\$ 1,276,102</u>



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF THE COOPERATIVE AND SUMMARY OF SIGNIFICANT  
ACCOUNTING POLICIES (CONTINUED)

2. Deposits and Investments - Credit Risk, Concentrations of  
Credit Risk and Interest Rate Risk (concluded)

The Real Estate Mortgage Investment Conduits (REMICs) and Collateralized Mortgage Obligations (CMOs) are categorized based on their due date. Many of the REMICs and CMOs pay principal throughout their life.

The Real Estate Mortgage Investment Conduits (REMICs) and Collateralized Mortgage Obligations (CMOs) above do not qualify as lawful investments under state law.

Interest Rate Risk - The Cooperative does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Concentration of Credit Risk - The Cooperative places no limit on the amount that may be invested in any one issuer.

Custodial Credit Risk - The Cooperative's investments are in a safekeeping account held by RBC Wealth Management which has been designated its fiscal agent. There is no investment policy limiting the amount that can be held by one fiscal agent.

3. Cooperative Benefits

Cooperative liabilities for health claims incurred but not reported are estimated by the third party administrator based on experience and claims filed after the Cooperative's year-end.

4. Reinsurance

The Cooperative uses a reinsurance agreement to reduce its exposure to large losses from health claims. Reinsurance permits recovery of a portion of claims from a reinsurer, although it does not discharge the primary liability of the Cooperative as direct insurer of the risk reinsured. The Cooperative does not report reinsured risks as liabilities



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
JUNE 30, 2016 AND 2015

NOTE 1 - DESCRIPTION OF THE COOPERATIVE AND SUMMARY OF SIGNIFICANT  
ACCOUNTING POLICIES (CONCLUDED)

Reinsurance (Continued)

unless it is probable that those risks will not be covered by the reinsurer. Premiums paid to the reinsurers during the years ended June 30, 2016 and 2015 were \$787,089 and \$735,287 and the amount deducted from claims liabilities as of June 30, 2016 and 2015 for reinsurance were \$227,100 and \$551,773.

5. Cash and Cash Equivalents

For the purpose of the Statement of Cash Flows, the Cooperative considers certificates of deposit and all highly liquid investments and deposits with a term to maturity of three months or less when purchased to be cash equivalents.

6. Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.

7. Revenue and Expense Classifications

In the proprietary fund's Statements of Revenue, Expenses and Changes in Net Position, revenues and expenses are classified in a manner consistent with how they are classified in the Statements of Cash Flows. That is, transactions for which related cash flows are reported as capital and related financing activities, noncapital financing activities, or investing activities are not reported as components of operating revenues or expenses.

8. Equity Classifications

Equity is classified as net position. The Cooperative has only unrestricted net position. Unrestricted net position is defined as all net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 JUNE 30, 2016 AND 2015

**NOTE 2 - UNPAID CLAIMS LIABILITIES**

As discussed in Note 1, the Cooperative establishes a liability for both reported and unreported insured events, which includes estimates of future payments and losses. The following represents changes in those aggregate liabilities for the Cooperative during the years ended June 30, 2016 and 2015:

	2016	2015
Amounts currently payable and estimated incurred but not reported to or for participants and dependents.		
Balance at beginning of year	\$ 297,608	\$ 334,126
Claims reported and approved for payment	3,270,827	3,557,453
Claims paid	( 3,270,827)	( 3,557,453)
Increase (decrease) in estimated claims incurred but not reported	64,144	( 36,518)
Balance at end of year	\$ 361,752	\$ 297,608

**NOTE 3 - RELATED PARTY**

Black Hills Special Services Cooperative (BHSSC) provides office space, office supplies, and wages for the business manager for the Cooperative. The Cooperative reimburses BHSSC \$500 a month for these expenses for a total of \$6,000 and \$6,000 for the periods ended June 30, 2016 and 2015, respectively.

**NOTE 4 - EXCESS RISK HEALTH INSURANCE AND LIFE INSURANCE**

The Cooperative purchases excess risk insurance covering claims over \$70,000 per policy year per covered person. The policy has an unlimited annual and lifetime limit. The Cooperative also purchases life insurance for plan participants.

**NOTE 5 - ELIGIBLE INVESTMENTS**

The Cooperative has invested in Real Estate Mortgage Investment Conduits (REMICs) and Collateralized Mortgage Obligations (CMOs) which, because they are derivatives of the underlying



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
NOTES TO FINANCIAL STATEMENTS (CONCLUDED)  
JUNE 30, 2016 AND 2015

NOTE 5 - ELIGIBLE INVESTMENTS (CONTINUED)

securities, do not qualify as lawful investments under SDCL 4-5-6. These investments make up approximately 8% of total investments.

The Cooperative has ceased investing in REMICs and CMOs.

NOTE 6 - RISK MANAGEMENT

The Cooperative is exposed to various risks of loss related to torts and errors and omissions. During the period ended June 30, 2016, the Cooperative managed its risks as follows:

Liability Insurance

The Cooperative purchases liability insurance for risks related to torts and errors and omissions of directors and officers from a commercial carrier. There have been no claims resulting from these risks during the past three years.

NOTE 7 - SUBSEQUENT EVENTS

The Cooperative had no subsequent events requiring recording or disclosure in the financial statements through December 15, 2016, which is the date the financial statements were available for issue.



BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
SCHEDULE OF AUDIT FINDINGS  
JUNE 30, 2016

PRIOR AUDIT FINDINGS

Finding 2015-1 Segregation of Duties

This finding has been restated as current audit finding 2016-1.

Finding 2015-2 Qualified Investments

This finding has been restated as current audit finding 2016-2.

CURRENT AUDIT FINDINGS

Finding 2016-1 Segregation of Duties

Criteria

A good system of internal accounting control includes the segregation of duties of accounting personnel, where no one individual has control over the assets, records transactions, and authorizes transactions.

Condition

Black Hills Educational Benefits Cooperative (BHEBC) does not have an adequate segregation of duties over the general operating and investment accounts.

Cause

The size of the BHEBC staff does not provide for an optimum segregation of duties, although several compensating monitoring controls have been implemented.

Effect

One person has control of the assets, records transactions and authorizes transactions.

Recommendation

Many compensating monitoring activities have been implemented using the board of directors and Black Hills Special Services Cooperative employees. The board of directors and manager should continue to implement and perform all practical oversight and review functions.

Management's Response

BHEBC does not employ any staff. BHEBC contracts with Black Hills Special Services Cooperative (BHSSC) for fiscal services. Because of the limited number of banking, investment, and general ledger transactions during the year, the fiscal services are provided





BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
SCHEDULE OF AUDIT FINDINGS (CONTINUED)  
JUNE 30, 2016

CURRENT AUDIT FINDINGS (CONTINUED)

Finding 2016-1 Segregation of Duties (Continued)

primarily by the business manager, with compensating monitoring activities by the board of directors, the independent claims administrator and other BHSSC staff. All premiums received are monitored by the independent claims administrator, Wellmark, and all individual claims paid are reviewed, approved and paid by Wellmark. Due to its size, it is not cost beneficial to take further corrective action.

Finding 2016-2 Qualified Investments

Criteria

The Cooperative is required to follow SDCL 4-5-6 requirements for investments.

Condition

Investments in Real Estate Mortgage Investment Conduits (REMICs) and Collateralized Mortgage Obligations (CMOs) of the Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Government National Mortgage Association (GNMA) do not qualify as lawful investments under SDCL 4-5-6.

Cause

The BHEBC and its fiscal agent, RBC Wealth Management, were unaware that the REMICs and CMOs were not lawful investments under South Dakota law.

Effect

The Cooperative is invested in unlawful investments.

Recommendation

The Cooperative should cease its investment in REMICs and CMOs and take all prudent steps to dispose of existing REMICs and CMOs in its portfolio.

Management's Response

BHEBC has instructed RBC Wealth Management to discontinue investing in these securities. The remaining will be sold as necessary to pay claims.

