



## CALIFORNIA HEALTH BENEFIT EXCHANGE (COVERED CALIFORNIA)

### Financial Statements and Reports Required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*

Year ended June 30, 2014 and 2013

#### SUMMARY OF RESULTS

##### BACKGROUND

In 2010, California was the first state in the nation to enact legislation creating a health insurance exchange under the Federal health care reform known as the Affordable Care Act (ACA). Under the ACA each state can choose to operate their own State-based Marketplace, or participate in a Federal Marketplace. California elected to operate its own State-based Marketplace establishing the California Health Benefit Exchange (Exchange), now known as Covered California. Covered California's vision is to improve the health of all Californians by assuring their access to affordable, high quality care.

Implementing Title 45, Code of Federal Regulations (CFR) §155.1200(c) the Center of Consumer Information and Insurance Oversight (CCIIO) of the Centers for Medicare and Medicaid services requires State-based Marketplaces to have annual financial and programmatic audits conducted by independent external auditors, in accordance with generally accepted governmental auditing standards promulgated by the Comptroller General of the United States. Such external independent audits are to be submitted to CCIIO via the web-based State-based Marketplace Annual Reporting Tool.

Furthermore, the Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, Subpart B -- Audits, Section 200(b) requires that non-federal entities that expend \$500,000 or more in a year in federal awards shall have a single audit conducted in accordance with Section 500, except when they elect to have a program-specific audit conducted in accordance with paragraph (c) of this section.

Since September 2010, Covered California received federal establishment grants totaling \$1.1 billion to establish and operate the Exchange through December 2014.

However, Covered California has received federal approval to roll over unspent federal grant funds to calendar year 2015 to cover establishment expenditures through December 2015. Under the state statute that established Covered California, it cannot rely on the State of California general funds to support its operations. Therefore, starting January 1, 2015, upon the expiration of the authority to spend federal grant funds, Covered California must be fully self-sufficient based on administrative fee revenue (enrollment fees assessed on health insurance companies for policies sold to individuals and businesses) raised in its operations.

Fiscal year 2013-14 was the second full year of operations for Covered California. During the first open enrollment period (October 1, 2013- March 31, 2014), Covered California enrolled approximately 1.4 million individuals into its health insurance marketplace. Covered California's funding for fiscal year 2013-14 included federal grant funds and monthly fees revenue assessed on qualified participating health plans.

Covered California's expenditures in fiscal year 2013-14 focused on essential core activities to continue establishment of the Exchange and to prepare for and support its first open enrollment, including:

- Promoting and facilitating enrollment
- Outreach and communications activities
- Service Center Operations

As stated above for the focused goals, Covered California has made, and continues to make progress through accelerated planning, development, and implementation activities. Covered California is actively engaged in ongoing policy development, government relations, and legal functions to support ongoing implementation activities. At Covered California's Board meeting in June 2014, the Board adopted its fiscal year 2014-15 budget, authorizing operational expenditures of \$442.8 million primarily devoted to promoting and facilitating retention and new enrollment, sales enrollment activities, and Service Center operations.

The Covered California Board actively embraced its role as an active purchaser and worked with staff, stakeholders, providers, health plans, and regulators to develop selection criteria, solicitation procedures, and contract standards for qualified health plans to be in the Exchange. Covered California's selection criteria and standardization drove good product development, resulting in a competitive mix of 11 health insurance companies offering different coverage types. This led to increased competition in the individual insurance market which benefited more than 83 percent of Covered California enrollees, who received federal subsidies to lower premiums costs. Covered California's 2015 outlook will continue to offer good products at an affordable cost with 10 health insurance companies.

Since the close of the first open enrollment period, Covered California has been focusing on revising and enhancing the consumer experience and the customer journey for individuals seeking and enrolling with Covered California. Covered California implemented an Outreach and Education Grant Program to promote public awareness and to inform consumers and small businesses about their options to obtain affordable health coverage through Covered California. In addition, Covered California has been implementing a multiyear, multiethnic, multi-language outreach, marketing, public awareness, and enrollment assistance program. Campaigns will continue through the second open enrollment period with media support vehicles including television, radio, print, out-of-home, digital, search engine marketing, social media, and direct mail throughout the state to reach the target audiences of subsidy eligible Californians.

Covered California implemented a centralized multisite service center model. The service center's role is to maximize enrollment of eligible individuals and small employers.

## **SCOPE AND OBJECTIVES**

Covered California contracted with KPMG to audit Covered California's fiscal year 2013-2014 financial statements, as well as perform an audit of Covered California's major federal program. KPMG performed procedures to obtain audit evidence about the amounts and disclosures in the financial statements; assessed risks of material misstatement of the financial statements; considered internal controls relevant to Covered California's preparation and fair presentation of the financial statements; evaluated the appropriateness of accounting policies used and the reasonableness of significant estimates made by management; evaluated the overall presentation of the financial statements; performed limited procedures to the required supplementary information; and reported on compliance over the major federal program; as well as reported on internal controls over compliance of the major federal program.

## **AUDITORS' RESPONSIBILITY**

### **Financial Statements**

The auditors' responsibility is to express an opinion on these financial statements based on the audit. The audit was conducted 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 the auditors plan and perform the

audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

OMB Circular A-133, Single Audit

The auditors' responsibility is to express an opinion on compliance with the requirements of laws, regulations, contracts, and grants applicable to Covered California's major federal program based on their audit. KPMG conducted their audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

**INTENTIONALLY LEFT BLANK**

## FINANCIAL STATEMENTS

### CALIFORNIA HEALTH BENEFIT EXCHANGE (COVERED CALIFORNIA)

Management's Discussion and Analysis (Unaudited)

June 30, 2014 and 2013

#### Condensed Summary of Net Position

A summary of Covered California's net position is presented below:

	<u>June 30, 2014</u>	<u>June 30, 2013</u>	<u>June 30, 2012</u>
Current and other assets	\$ 179,424,269	49,926,183	2,144,766
Capital assets	<u>247,178,201</u>	<u>122,358,199</u>	<u>31,876</u>
Total assets	<u>426,602,470</u>	<u>172,284,382</u>	<u>2,176,642</u>
Current liabilities	115,475,780	50,070,897	2,176,642
Noncurrent liabilities	<u>3,266,847</u>	<u>2,628,404</u>	<u>357,882</u>
Total liabilities	<u>118,742,627</u>	<u>52,699,301</u>	<u>2,534,524</u>
Investment in capital assets	247,178,201	122,358,199	31,876
Unrestricted (deficit)	<u>60,681,642</u>	<u>(2,773,118)</u>	<u>(389,758)</u>
Total net position	<u>\$ 307,859,843</u>	<u>119,585,081</u>	<u>(357,882)</u>

#### Condensed Summary of Changes in Net Position

A summary of Covered California's change in net position is presented below:

	<u>June 30, 2014</u>	<u>June 30, 2013</u>	<u>June 30, 2012</u>
Operating revenues	\$ 67,168,160	-	-
Operating expenses	<u>353,438,337</u>	<u>43,746,280</u>	<u>6,724,630</u>
Operating loss	(286,270,177)	(43,746,280)	(6,724,630)
Nonoperating revenue	<u>324,154,982</u>	<u>24,370,265</u>	<u>6,334,872</u>
Income (loss) before capital contributions	37,884,805	(19,376,015)	(389,758)
Capital contributions	<u>150,389,957</u>	<u>139,318,978</u>	<u>31,876</u>
Changes in net position	188,274,762	119,942,963	(357,882)
Total net position- beginning of year	<u>119,585,081</u>	<u>(357,882)</u>	<u>-</u>
Total net position- end of year	<u>\$ 307,859,843</u>	<u>119,585,081</u>	<u>(357,882)</u>

**CALIFORNIA HEALTH BENEFIT EXCHANGE  
(COVERED CALIFORNIA)**

Statements of Net Position

June 30, 2014 and 2013

<b>Assets</b>	<b>2014</b>	<b>2013</b>
Current assets:		
Cash and cash equivalents	\$ 21,349,158	18,296,555
Receivables:		
Enrollment fees (net of allowance of \$6,664,178 in 2014 and \$0 in 2013)	65,381,733	—
Grants receivable	65,576,455	14,623,439
Receivables from state agencies	27,041,771	16,992,655
Other receivables	71,498	12,114
Total receivables	158,071,457	31,628,208
Other current assets	3,654	1,420
Total current assets	179,424,269	49,926,183
Noncurrent assets:		
Capital assets, net	247,178,201	122,358,199
Total assets	426,602,470	172,284,382
<b>Liabilities</b>		
Current liabilities:		
Accounts payable	110,414,774	49,768,436
Accrued liabilities	2,189,835	157,747
Compensated absences	2,871,171	144,714
Total current liabilities	115,475,780	50,070,897
Noncurrent liabilities:		
Compensated absences	1,777,746	2,502,922
Other liabilities	1,489,101	125,482
Total noncurrent liabilities	3,266,847	2,628,404
Total liabilities	118,742,627	52,699,301
<b>Net Position</b>		
Net investment in capital assets	247,178,201	122,358,199
Unrestricted (deficit)	60,681,642	(2,773,118)
Total net position	\$ 307,859,843	119,585,081

**CALIFORNIA HEALTH BENEFIT EXCHANGE  
(COVERED CALIFORNIA)**

Statements of Revenues, Expenses, and Changes in Net Position  
Years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating revenues:		
Enrollment fees Individual	\$ 63,647,148	—
Enrollment fees SHOP	3,521,012	—
Total operating revenues	<u>67,168,160</u>	<u>—</u>
Operating expenses:		
Salaries, wages, benefits	53,300,444	9,224,157
Operating expenses and equipment	3,319,145	4,450,873
Professional services	254,808,242	27,703,332
Commissions fees	11,265,137	—
Facilities operations	4,783,066	2,177,332
Communications	594,018	169,997
Depreciation expense	25,368,285	20,589
Total operating expenses	<u>353,438,337</u>	<u>43,746,280</u>
Operating loss	<u>(286,270,177)</u>	<u>(43,746,280)</u>
Nonoperating revenues:		
Operating federal grants	307,964,342	24,353,378
State – reimbursements	16,379,865	—
Interest income	12,445	16,887
Other expense	(201,670)	—
Total nonoperating revenues	<u>324,154,982</u>	<u>24,370,265</u>
Income (loss) before capital contributions	<u>37,884,805</u>	<u>(19,376,015)</u>
Capital contributions:		
Federal	123,319,765	122,326,323
State reimbursements	27,070,192	16,992,655
Total capital contributions	<u>150,389,957</u>	<u>139,318,978</u>
Change in net position	188,274,762	119,942,963
Total net position – beginning of year	<u>119,585,081</u>	<u>(357,882)</u>
Total net position – end of year	<u>\$ 307,859,843</u>	<u>119,585,081</u>

**CALIFORNIA HEALTH BENEFIT EXCHANGE  
(COVERED CALIFORNIA)**

Statements of Cash Flows

Years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Receipts from enrollment fees	\$ 1,786,427	—
Payments to employees and for employee benefits	(47,962,840)	(6,651,174)
Payments to suppliers	<u>(252,993,553)</u>	<u>(1,570,605)</u>
Net cash used in operating activities	<u>(299,169,966)</u>	<u>(8,221,779)</u>
Cash flows from noncapital financing activities:		
Operating grants	283,964,916	12,935,801
State - reimbursements	<u>16,379,865</u>	<u>—</u>
Net cash provided by noncapital financing activities	<u>300,344,781</u>	<u>12,935,801</u>
Cash flows from capital and related financing activities:		
Capital grants	113,387,251	119,794,960
Acquisition of capital assets	<u>(111,521,908)</u>	<u>(107,687,467)</u>
Net cash provided by capital and related financing activities	<u>1,865,343</u>	<u>12,107,493</u>
Cash flows from investing activities:		
Interest income	<u>12,445</u>	<u>16,887</u>
Net increase in cash and cash equivalents	3,052,603	16,838,402
Cash and cash equivalents – beginning of year	<u>18,296,555</u>	<u>1,458,153</u>
Cash and cash equivalents – end of year	<u>\$ 21,349,158</u>	<u>18,296,555</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	(286,270,177)	(43,746,280)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	25,368,285	20,589
Changes in assets and liabilities:		
Increase in accounts receivable	(65,381,733)	—
Increase in other assets	(2,234)	(1,420)
Increase in accounts payable	21,778,289	32,932,349
Increase in accrued liabilities	1,972,704	157,747
Increase in compensated absences	2,001,281	2,289,754
Increase in other liabilities	<u>1,363,619</u>	<u>125,482</u>
Net cash used in operating activities	<u>\$ (299,169,966)</u>	<u>(8,221,779)</u>



## FEDERAL EXPENDITURES

### CALIFORNIA HEALTH BENEFIT EXCHANGE (COVERED CALIFORNIA)

Schedule of Expenditures of Federal Awards  
Year ended June 30, 2014

<u>Federal Grantor</u>	<u>Program Title</u>	<u>CFDA No.</u>		<u>Federal Expenditures</u>
U.S. Department of Health and Human Services	State Planning and Establishment Grants for the Affordable Care Act (ACA)'s Exchanges	93.525	\$	431,284,107

## OPINION

### Financial Statements

In the auditors' opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Covered California as of June 30, 2014 and 2013, and the respective changes in financial position and its cash flows thereof for the years then ended in accordance with U.S. generally accepted accounting principles.

### OMB Circular A-133, Single Audit

In the auditors' opinion, Covered California complied, in all material respects, with the types of compliance requirements described in the OMB Circular A-133 Compliance Supplement that could have a direct and material effect on its major federal program for the year ended June 30, 2014.

## AUDIT FINDING

***Finding 1 (Reference 2014-001). Covered California did not have adequate controls in place to review top-side journal entries made to report amounts in accordance with generally accepted accounting principles. The auditors identified four errors in the financial statement which were subsequently corrected by Covered California, as follows:***

### *Revenue:*

1. At June 30, 2014, Covered California had collected \$3.4 million in SHOP payments that it had not applied to invoices, resulting in an overstatement of accounts receivable.
2. Covered California identified that not all revenue billed for Individual enrollment fees is collectable as it is still in the process of determining if all individuals are fully effectuated. However, Covered California did not report an allowance to properly reflect uncollectible amounts. As a result, Individual enrollment fee revenue was overstated by approximately \$3.2 million.

### *Other Financial Statement Items:*

1. Covered California expensed \$8.0 million of costs that should have been capitalized as part of the California Healthcare Eligibility, Enrollment, and Retention System (CalHEERS).
2. Covered California did not recognize \$12.5 million of revenue from the Department of Healthcare Services (DHCS) and overstated its receivable from DHCS by \$10.8 million.

### *Recommendation for Finding 1*

Covered California should develop policies and procedures and provide training to staff to ensure the financial statements are accurate. Specifically, Covered California should:

- Implement a process to apply SHOP payment collections to invoices on a timely basis.
- Implement a process to determine the allowance for uncollectible Individual enrollment revenue.
- Evaluate individual invoices to ensure proper capitalization on the CalHEERS costs.

- Evaluate invoices with DHCS to ensure the revenue and receivable balances are accurately reported.

Corrective Action Plan for Finding 1

Covered California concurs with the finding and has taken corrective actions to ensure that:

- SHOP payments are applied to invoices in a timely basis.
- Per member per month fees are accurately billed, and revenue and the associated allowance for non-effectuated members is properly reflected.
- CalHEERS costs are properly capitalized.
- DHCS revenue and receivable balances are properly reported on the financial statements and invoices are received in a timely manner.

*Note: As of April 2015, corrective actions have been fully implemented.*