



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

Fiscal Year ended June 30, 2015

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 Patient Protection and Affordable Care Act (ACA). Under the ACA each state can choose to operate their own State-based Marketplace, or participate in the Federal Marketplace. California elected to operate its own State-based Marketplace establishing the California Health Benefit Exchange (Exchange), also 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 regulations at Title 45, Code of Federal Regulations (CFR) §155.1200(c) by the Center of Consumer Information and Insurance Oversight (CCIIO) of the Centers for Medicare and Medicaid Services (CMS) required State-based Marketplaces to have annual financial and programmatic audits conducted by independent external auditors.

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.

Covered California partially relied on federal grant funding and enrollment fees for its operations and received federal approval to use unspent federal grant funds through September 30, 2016. The approval of the extension of the federal grant gave Covered California more time to establish the organization as it worked toward its goal of identifying the most efficient and cost-effective structure possible.

Additionally, during fiscal year 2014-2015, as required by the Governmental Accounting Standards Board (GASB), Covered California implemented the GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. The primary objective of this statement is to improve accounting and financial reporting by state and local governments for pensions. This Statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, expenses, and requires recognition of a liability equal to the net pension liability, which is measured as the total pension liability, less the amount of the pension's fiduciary net position.

SCOPE AND OBJECTIVES

Covered California contracted with KPMG to audit Covered California's fiscal year 2014-2015 financial statements, as well as perform an audit of Covered California's major federal program. As part of their 2014/15 scope, KPMG:

- Performed procedures to obtain audit evidence about the amounts and disclosures in the financial statements;
- Assessed risks of material misstatements 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;
- Reported on compliance of the major federal program; as well as reported on internal controls over compliance of the major federal program.

AUDITORS' RESPONSIBILITY

Financial Statements

The auditor's 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*.

FINANCIAL STATEMENTS

CALIFORNIA HEALTH BENEFIT EXCHANGE (COVERED CALIFORNIA)

June 30, 2015

Condensed Summary of Net Position

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

	June 30, 2015	June 30, 2014
Current and other assets	\$ 297,114,950	179,424,269
Capital assets	245,650,865	247,178,201
Total assets	542,765,815	426,602,470
Deferred outflow of resources	11,090,990	-
Total assets and deferred outflows of resources	553,856,805	426,602,470
Current liabilities	91,123,868	115,475,780
Noncurrent liabilities	8,544,873	3,266,847
Net pension liability	53,473,665	-
Total liabilities	153,142,406	118,742,627
Deferred inflows of resources	10,560,585	-
Total liabilities and deferred outflows of resources	163,702,991	118,742,627
Investment in capital assets	245,650,865	247,178,201
Unrestricted (deficit)	144,502,949	60,681,642
Total net position	\$ <u>390,153,814</u>	<u>307,859,843</u>

Condensed Summary of Changes in Net Position

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

	June 30, 2015	June 30, 2014
Operating revenues	\$ 207,446,678	67,168,160
Operating expenses	399,815,350	353,438,337
Operating loss	(192,368,672)	(286,270,177)
Nonoperating revenue	306,986,449	324,154,982
Income (loss) before capital contributions	114,617,777	37,884,805
Capital contributions	27,669,396	150,389,957
Changes in net position	142,287,173	188,274,762
Total net position- beginning of the year	307,859,843	119,585,081
Cumulative effect of accounting change	(59,993,202)	-
Total net position- end of year	\$ <u>390,153,814</u>	<u>307,859,843</u>

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

Statement of Net Position

June 30, 2015

Assets and Deferred Outflows

Current assets:	
Cash and cash equivalents	\$ 239,675,495
Receivables:	
Enrollment fees (net of allowance for cancelled enrollments)	41,836,437
Receivables from state agencies	14,302,044
Other receivables	1,269,253
Total receivables	57,407,734
Other current assets	31,721
Total current assets	297,114,950
Noncurrent assets:	
Capital assets, net	245,650,865
Total assets	542,765,815
Deferred outflows of resources	
Total assets and deferred outflows of resources	\$ 553,856,805

Liabilities and Deferred Inflows

Current liabilities	
Accounts payable	\$ 59,337,860
Grants received in advance	22,186,084
Accrued liabilities	1,690,861
Deferred revenue	3,998,380
Compensated absences	3,910,683
Total current liabilities	91,123,868
Noncurrent liabilities:	
Compensated absences	1,805,854
Other liabilities	6,739,019
Net pension liability	53,473,665
Total noncurrent liabilities	62,018,538
Total liabilities	153,142,406
Deferred inflows of resources	
Total liabilities and deferred inflows of resources	10,560,585
Total liabilities and deferred inflows of resources	163,702,991

Net Position

Net investment in capital assets	\$ 245,650,865
Unrestricted	144,502,949
Total net position	390,153,814

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

Statement of Revenues, Expenses, and Changes in Net Position

Year ended June 30, 2015

Operating revenues:	
Enrollment fees-individual	\$ 204,314,367
Enrollment fees-CCSB	3,132,311
Total operating revenue	207,446,678
Operating expenses:	
Salaries, wages, benefits	80,232,822
Operating expenses and equipment	7,701,831
Professional services	250,258,509
Enrollment assistance fees	18,897,592
Facilities operations	6,976,657
Communications	379,769
Depreciation expense	35,368,170
Total operating expenses	399,815,350
Operating loss	(192,368,672)
Nonoperating revenues:	
Federal grants	287,868,268
State - Reimbursements	18,902,293
Interest income	215,888
Total nonoperating revenues	306,986,449
Income before capital contributions	114,617,777
Capital contributions:	
Federal	27,669,396
Total capital contributions	27,669,396
Change in net position	142,287,173
Total net position - beginning of year, as previously stated	307,859,843
Cumulative effect of accounting change	(59,993,202)
Total net position - beginning balance, as restated	247,866,641
Total net position - end of year	\$ 390,153,814

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

Statement of Cash Flows

Year ended June 30, 2015

Cash flows from operating activities:	
Receipts from enrollment fees	\$ 234,548,511
Payments to employees for employee benefits	(81,658,956)
Payments to suppliers	(290,066,946)
Net cash used in operating activities	<u>(137,177,391)</u>
Cash flows from noncapital financing activities:	
Operating grants	336,520,123
State - reimbursements	21,268,328
Net cash provided by noncapital financing activities	<u>357,788,451</u>
Cash flows from capital and related financing activities:	
Capital grants	54,534,343
Acquisition of capital assets	(56,907,145)
Net cash provided by capital and related financing activities	<u>(2,372,802)</u>
Cash flows from investing activities:	
Interest income	88,079
Net increase in cash and cash equivalents	<u>218,326,337</u>
Cash and cash equivalents - beginning of year	<u>21,349,158</u>
Cash and cash equivalents - end of year	<u>239,675,495</u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	(192,368,672)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Depreciation	35,368,170
Changes in assets and liabilities:	
Decrease in accounts receivable	27,101,833
Increase in other assets	(28,067)
Increase in pension obligations	(530,405)
Decrease in accounts payable and grants received in advance	(5,824,520)
Decrease in accrued liabilities	(7,213,268)
Increase in compensated liabilities	1,067,619
Increase in other liabilities	5,249,919
Net cash used in operating activities	<u>\$ (137,177,391)</u>
Supplemental disclosure of noncash activities:	
Capital asset purchases included in accounts payable	\$ 15,801,740

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

Notes to Financial Statements

June 30, 2015

Capital Assets

Changes in capital assets for the year ended June 30, 2015 are as follows:

	Balance			Balance
	July 1, 2014	Increases	Decreases	June 30, 2015
Depreciable assets-development costs:				
Internally developed hardware	207,379,877	28,147,421	-	235,527,298
Hardware	21,772,260	990,677	-	22,762,937
Licenses and purchased software	39,567,465	1,262,163	-	40,829,628
Total depreciable assets development costs	\$ 268,719,602	30,400,261		299,119,863
Depreciable capital assets:				
Office furniture and equipment	3,465,602	1,054,428		4,520,030
Leasehold improvements	381,871	2,386,145		2,768,016
Total depreciable capital assets	3,847,473	3,440,573	-	7,228,046
Less accumulated depreciation:				
Asset development costs	(24,754,450)	(34,293,964)		(59,048,414)
Office furniture and equipment	(585,462)	(819,555)		(1,405,017)
Leasehold improvements	(48,962)	(254,651)		(303,613)
Total accumulated depreciation	(25,388,874)	(35,368,170)		(60,757,044)
Total capital assets, net	\$ 247,178,201	(1,527,336)	-	245,650,865

FEDERAL EXPENDITURES

COVERED HEALTH BENEFIT EXCHANGE (COVERED CALIFORNIA)

Schedule of Expenditures of Federal Awards

Year ended June 30, 2015

<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	\$ 315,537,664

OPINION

Financial Statements

In the auditors' opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Covered California as of June 30, 2015, and the changes in the financial position and its cash flows thereof for the years then ended in accordance with the 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, 2015.

AUDIT FINDINGS

After a thorough review of Covered California's financial records performed by KPMG, three findings were identified for Covered California, which were related to internal controls over top-sided journal entries, incorrect posting of an expenditure, and controls surrounding changes in allowability requirements. However, no findings were found to impact Covered California's financial position.

Finding 2015-001: During their audit, KPMG found that Covered California does not have adequate controls in place to review the top-side journal entries made to report amounts in accordance with generally accepted accounting principles (GAAP). The auditors identified errors in the financial statements which were subsequently corrected by Covered California, as follows:

Revenue:

- At June 30, 2015, Covered California had an overstatement of accounts receivable and revenues of approximately \$2.2 million, an overstatement of Federal Grant Revenue and Receivable of approximately \$1.0 million, and an understatement of \$1.4 million in the Accounts Receivable and Accounts Payable balance sheet accounts, and the related revenue and expense.

Capital Assets:

- Covered California had an approximate \$2.3 million understatement of capital assets and an overstatement of operating expenses as well as an understatement of accumulated depreciation and depreciation expense of approximately \$3.0 million.

Other State Agencies:

- Covered California understated its receivables and revenues by approximately \$2.1 million and recognized \$1.2 million in the current year that should have been reported in the prior year.

Recommendation for Finding 2015-001

Covered California should develop policies and procedures to ensure the financial statements are accurately presented in accordance with generally accepted accounting principles.

Corrective Action Plan for Finding 2015-001

Because of the Exchange's unique structure, Budgetary/Legal financial statements are prepared at year-end, as well as stand-alone GAAP financial statements. The GAAP financial statements require a presentation of data that is different from what is captured in Covered California's accounting system, CALSTARS. The required conversions of financial data are termed top-side entries.

Covered California immediately implemented corrective actions for identified top-side journal entries. Covered California is performing reconciliations to the general ledger for its revenue accounts, and continues to review GAAP entries for accuracy including calculations. Covered California has also engaged in dialog with other state agencies to obtain timely invoices.

Note: This corrective action requires continuous implementation.

Finding 2015-002: Grant funds were used to pay a legal settlement to a former employee. The settlement costs were paid in lieu of incurring litigation proceeding costs, and Covered California used grant funds to pay this expenditure. Such settlement costs are not allowable under OMB Circular A-87. As a result, Covered California has incurred unallowable costs under the terms of the grant agreement.

Recommendation for Finding 2015-002

Covered California should reimburse the disallowed costs to the Federal Government. In addition, Covered California should use its sustainability funds to cover such future expenses.

Corrective Action Plan for Finding 2015-002

Covered California concurs with this finding. The Financial Management Division (FMD) reviewed expenditures through FY15-16 to ensure no costs resulting from violations of, alleged violations of, or failure to comply with, Federal, state, tribal, local or foreign laws and regulations were charged to the Federal grant.

Covered California concurs that a transaction for a single payment in the amount of \$55,000 was posted to the incorrect fund. The expenditure was corrected and charged against sustainability funds. Covered California disagrees that an error for a single payment is indicative of a lack of adequate expenditure review controls.

Note: As of July 2015, this corrective action has been fully implemented.

Finding 2015-003: During fiscal year 2014-15, Covered California claimed certain expenditures that were not allowable under the provisions of Section 1311 of the Affordable Care Act. Beginning January 1, 2015, Covered California was required to comply with Section 1311 (5)(A) of the Affordable Care Act which provides for the use of sustainability funds to cover ongoing operating expenditures. Covered California management identified the unallowable costs and has indicated that the Federal Government was reimbursed for such costs through a reduction of draws submitted subsequent to its 2014-15 fiscal year end.

Recommendation for Finding 2015-003

Covered California should strengthen its existing monitoring controls surrounding changes in allowability requirements to ensure that all expenditures claimed under the grant meet the grant requirements.

Corrective Action Plan for Finding 2015-003

Covered California disagrees with this finding. The condition for this finding does not provide sufficient detail regarding the advice received on allowable costs from CMS on June 8, 2015, that was retroactive to January 1, 2015; therefore, the suggested recommendation of strengthening monitoring controls would not have avoided the adjustments noted above. At the time the expenditures occurred, the costs were allowable and Covered California was in compliance with Section 1311 (5) (A). However, on June 8, 2015, three weeks before the end of the state fiscal year and six months after the beginning of the self-sustainability period cited in Section 1311 (5) (A), CMS released Frequently Asked Questions (FAQs) stating, "Allowable uses of the 1311 funds after January 1, 2015 are for establishment activities that were specifically described in the grantee's approved work plan". Based on this new information, Covered California reviewed expenditures and made timely adjustments. All expenditure adjustments were completed before the end of the 2014-15 state fiscal year and no corrective action is necessary.

Further, the CMS confirmed the June 8, 2015, FAQs were issued as additional guidance to assist States on continuing ACA activities. Due to the timing of the FAQs, CMS expected that state-based marketplaces would require some accounting adjustments consistent with the additional guidance. Covered California's expenditure adjustments and subsequent offsets to grant draws was a reasonable and appropriate effort to mitigate the impact of the June 8, 2015, guidance.

Covered California was proactive and had appropriate expenditure reviews in place prior to claiming Federal expenditures. Covered California could not have predicted that CMS would provide additional guidance six months after the sustainability period began. At the time that the expenditures occurred, the costs were allowable and Covered California was in compliance with Section 1311 (5) (A).

Auditors' Conclusion

The additional guidance provided by CMS in its publication of the FAQs further clarified the types of expenditures that were no longer allowable under the grant as of January 1, 2015. As the Affordable Care Act included a requirement to use sustainability funds to

cover ongoing operating expenditures, we concluded that the questioned costs above were not allowable during the reporting period from January 1, 2015, to June 30, 2015.

Note: A review of the FAQs began in June 2015 and expenditure corrections were completed. No further action is necessary.