



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, 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.

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 \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) 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 has received federal establishment grants totaling \$1.1 billion to establish the Exchange and operate through December 2014. Under the state statute that established Covered California, it cannot rely on State of California general funds to support its operations. Starting January 1, 2015, upon the expiration of authority to spend federal grant funds, Covered California must be fully self-sufficient based on administrative fee revenue raised in its operations.

In December 2012, Covered California submitted a Blueprint to the federal government spelling out how it will operate in the years ahead. Covered California's Blueprint, conditionally approved in January 2013, demonstrated it will be self-sustaining with sufficient

administrative fee revenue to support ongoing operations. In addition, at Covered California's Board meeting in June 2013, the Board adopted guiding principles to steer its financial policies and also adopted a flexible financial planning approach that takes into account the uncertainties inherent with depending on revenue from an entirely new marketplace.

Fiscal year 2012-13 was the first full year of operations for Covered California. Covered California's expenditures in fiscal year 2012-13 focused on the following essential goals related to establishing Covered California:

- Developing information technology infrastructure
- Preparing to promote Covered California and its products through public relations and communications activities
- Establishing and staffing the Service Center

In order to develop its information technology infrastructure, Covered California began the development of the California Healthcare Eligibility, Enrollment, and Retention System (CalHEERS), which is an automated system that serves as the consolidated support system for eligibility, enrollment, and retention for Covered California, Medi-Cal, and Healthy Families.

The timing of significant expenditures during fiscal year 2012-13 occurred later than originally anticipated, which resulted in a delay of some expenditures to fiscal year 2013-2014. Hiring occurred at a much slower pace than originally budgeted due principally to the delay and challenges associated with recruiting staff in the Service Center. Contractual spending also occurred at a slower pace primarily due to the timing of media campaigns, the timing of Service Center development, and other activities. Funds were also used for tasks such as recruiting and training staff, gathering stakeholder input, and establishing the Small Business Health Options Program.

SCOPE AND OBJECTIVES

Covered California contracted with KPMG to audit Covered California's fiscal year 2012-2013 financial statements, as well as perform a single audit of Covered California's major federal program. KPMG performed procedures to obtain audit evidence of 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*.

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FINANCIAL STATEMENTS

CALIFORNIA HEALTH BENEFIT EXCHANGE (COVERED CALIFORNIA)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

Condensed Summary of Net Position

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

	June 30, 2013	June 30, 2012	\$ Change	% Change
Current and other assets	\$ 49,926,183	2,144,766	\$ 47,781,417	2,227.8%
Capital assets	<u>122,358,199</u>	<u>31,876</u>	<u>122,326,323</u>	383,756.8%
Total assets	<u>172,284,382</u>	<u>2,176,642</u>	<u>170,107,740</u>	7,815.1%
Current liabilities	50,070,897	2,176,642	47,894,255	2,200.4%
Noncurrent liabilities	<u>2,628,404</u>	<u>357,882</u>	<u>2,270,522</u>	634.4%
Total liabilities	<u>52,699,301</u>	<u>2,534,524</u>	<u>50,164,777</u>	1,979.3%
Invested in capital assets	122,358,199	31,876	122,326,323	383,756.8%
Unrestricted (deficit)	<u>(2,773,118)</u>	<u>(389,758)</u>	<u>(2,383,360)</u>	611.5%
Total net position	<u>\$ 119,585,081</u>	<u>(357,882)</u>	<u>\$ 119,942,963</u>	<u>(33,514.7)%</u>

Condensed Summary of Changes in Net Position

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

	June 30, 2013	June 30, 2012	\$ Change	% Change
Operating expenses	\$ 43,746,280	6,724,630	37,021,650	550.5%
Operating loss	<u>(43,746,280)</u>	<u>(6,724,630)</u>	<u>(37,021,650)</u>	550.5%
Nonoperating revenue	24,370,265	6,334,872	18,035,393	284.7%
Loss before capital contributions	(19,376,015)	(389,758)	(18,986,257)	4,871.3%
Capital contributions	<u>139,318,978</u>	<u>31,876</u>	<u>139,287,102</u>	436,965.4%
Changes in net position	119,942,963	(357,882)	120,300,845	(33,614.7)%
Total net position – beginning of year	<u>(357,882)</u>	<u>—</u>	<u>(357,882)</u>	<u>—</u>
Total net position – end of year	<u>\$ 119,585,081</u>	<u>\$ (357,882)</u>	<u>\$ 119,942,963</u>	<u>(33,514.7)%</u>

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

Statement of Net Position

June 30, 2013

Assets

Current assets:	
Cash and cash equivalents	\$ 18,296,555
Grants receivable	14,623,439
Accounts receivable	17,004,769
Other current assets	1,420
Total current assets	<u>49,926,183</u>
Noncurrent assets:	
Capital assets, net	<u>122,358,199</u>
Total assets	<u>172,284,382</u>

Liabilities

Current liabilities:	
Accounts payable	49,768,436
Accrued liabilities	157,747
Compensated absences	144,714
Total current liabilities	<u>50,070,897</u>
Noncurrent liabilities:	
Compensated absences	2,502,922
Other liabilities	125,482
Total non-current liabilities	<u>2,628,404</u>
Total liabilities	<u>52,699,301</u>

Net Position

Net investment in capital assets	122,358,199
Unrestricted (deficit)	<u>(2,773,118)</u>
Total net position	<u>\$ 119,585,081</u>

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

Statement of Revenues, Expenses, and Changes in Net Position

June 30, 2013

Operating expenses:	
Salaries, wages, benefits	\$ 9,224,157
Operating expenses and equipment	4,450,873
Professional services	27,703,332
Facilities operations	2,177,332
Communications	169,997
Depreciation expense	20,589
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Total operating expenses	43,746,280
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Operating loss	(43,746,280)
Nonoperating revenues:	
Operating grants	24,353,378
Interest income	16,887
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Total nonoperating revenues	24,370,265
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Loss before capital contributions	(19,376,015)
Capital contributions:	
Federal	122,326,323
State	16,992,655
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Total capital contributions	139,318,978
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Change in net position	119,942,963
Total net position – beginning of year	(357,882)
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Total net position – end of year	\$ 119,585,081
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**CALIFORNIA HEALTH BENEFIT EXCHANGE
(COVERED CALIFORNIA)**

Statement of Cash Flows

June 30, 2013

Cash flows from operating activities:	
Payments to employees and for employee benefits	\$ (6,651,174)
Payments to suppliers	<u>(1,570,605)</u>
Net cash used in operating activities	<u>(8,221,779)</u>
Cash flows from noncapital financing activities:	
Operating grants	<u>12,935,801</u>
Cash flows from capital and related financing activities:	
Capital grants	119,794,960
Acquisition of capital assets	<u>(107,687,467)</u>
Net cash provided by capital and related financing activities	<u>12,107,493</u>
Cash flows from investing activities:	
Interest income	<u>16,887</u>
Net increase in cash and cash equivalents	16,838,402
Cash and cash equivalents – beginning of year	<u>1,458,153</u>
Cash and cash equivalents – end of year	<u><u>\$ 18,296,555</u></u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	\$ (43,746,280)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Depreciation	20,589
Changes in assets and liabilities:	
Increase in other assets	(1,420)
Increase in accounts payable	32,932,349
Increase in accrued liabilities	157,747
Increase in compensated absences	2,289,754
Increase in other liabilities	<u>125,482</u>
Net cash used in operating activities	<u><u>\$ (8,221,779)</u></u>

FEDERAL EXPENDITURES

CALIFORNIA HEALTH BENEFIT EXCHANGE (COVERED CALIFORNIA)

Schedule of Expenditures of Federal Awards
Year ended June 30, 2013

<u>Federal Grantor</u>	<u>Program Title</u>	<u>CFDA No.</u>	<u>Federal Expenditures</u>
U.S. Department of Health and Human Services	Cooperative Agreements to Support Establishment of State-Operated Health Insurance Exchanges and Human Services	93.525	\$ 151,863,331

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, 2013, and the changes in financial position and cash flows for the year then ended in accordance with U.S. generally accepted accounting principles (GAAP).

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, 2013.

AUDIT FINDINGS

The Exchange is continually striving to progress. As a result of the audit, the following opportunities for improvement were identified.

Finding 1 (Reference 2013-001). Covered California lacks adequate controls to ensure revenue and accounts receivable are fairly presented.

At inception, California Department of Social Services performed accounting and grants management for Covered California, and Covered California had been considered a component unit of the State of California (State). In June 2013, Covered California took over accounting operations and grants management. In January 2014, upon adoption of Government Accounting Standards Board Statement No. 61, *The Financial Reporting Entity: Omnibus*, the State informed Covered California that it was now a related organization. As a result, Covered California was required to prepare its own financial statements for the first time for fiscal year 2012-13 in February 2014.

Historically, Covered California reported its financial information based on its budgetary balances in the State's general ledger. Covered California's first financial statement preparation did not evaluate whether certain revenue and accounts receivable balances should have been reversed as they did not represent transactions that related to fiscal year 2012-13. The balances represented encumbrances on the grant award that would be expended and drawn down from the federal government in fiscal year 2013-14.

As a result of this error, Covered California had grossed up its statement of revenues and expenses by not eliminating those revenue and accounts receivable balances. In addition, after recording capital assets, Covered California did not properly remove the capitalized expenditures from its operating expenses which resulted in an overstatement of operating expenditures and accounts payable. Covered California made adjustments to its financial statements to reflect these corrections.

Recommendation for Finding 1

Covered California should develop policies and procedures to report revenue and accounts receivable in accordance with generally accepted accounting principles.

Corrective Action Plan for Finding 1

Covered California concurs with this finding. Covered California has taken immediate action to begin revising existing accounting policies and procedures to ensure proper GAAP presentation of its revenue and accounts receivables. These actions include recruitment of a State GAAP financial statement experienced consultant, GAAP training for staff, and recruitment of vacant accounting positions with staff experienced and dedicated to governmental GAAP financial reporting requirements. Covered California

will include GAAP financial statement adjustments in the Accounting work plan to ensure completion of the various tasks related to the financial statement preparation process. Covered California will monitor, on a weekly basis, the work progress on the GAAP financial statements so that policies and procedures are met. Covered California will conduct a quarterly evaluation of the implemented procedures and provide additional policy, guidance, and training as appropriate.

Finding 2 (Reference 2013-002). Covered California lacks adequate controls to ensure its financial statements and Schedule of Expenditures of Federal Awards are accurate and complete.

During the audit, corrective actions were implemented in response to the following areas requiring improvement.

- Covered California did not properly evaluate transactions that took place by the end of the fiscal year to determine whether a liability existed at June 30, 2013, resulting in an understatement of accounts payable and expenditures.
- Covered California did not properly evaluate whether it needed to record a grant receivable and revenue to match expenditures that had been incurred but for which funds had not yet been drawn down from the federal government.
- During fiscal year 2012-13, Covered California was developing an information technology system that will facilitate the State's health insurance marketplace that was properly capitalized except for some expenses that were not properly evaluated.
- Covered California misclassified cash equivalents as accounts receivable.

Recommendation for Finding 2

Covered California should develop policies and procedures and provide training to staff to ensure its financial statements and Schedule of Expenditures of Federal Awards are accurate and complete. Covered California should:

- Implement procedures to identify and record accounts payable for goods and services received in the fiscal year but paid after year end.
- Implement procedures to accrue grant receivable based on expenditures incurred but not yet drawn.
- Evaluate individual contracts and invoices to ensure proper capitalization of the computer system.

- Review the financial statements to ensure proper presentation of cash and cash equivalents.

Corrective Action Plan for Finding 2

Covered California concurs with this finding. Covered California has taken immediate action to begin revising existing accounting policies and procedures to ensure proper GAAP presentation. These actions include recruitment of a State GAAP financial statement experienced consultant, GAAP training for staff, and recruitment of vacant accounting positions with staff experienced and dedicated to governmental GAAP financial reporting requirements. Covered California will include GAAP financial statement adjustments in the Accounting work plan to ensure completion of the various tasks related to the financial statement preparation process.

In response to the recommendations, the above corrective actions were fully implemented as of September 2014.