



**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

(With Independent Auditors' Reports Thereon)

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

**Table of Contents**

	<b>Page</b>
<b>Financial Statements</b>	
Independent Auditors' Report	1
Management's Discussion and Analysis (Unaudited)	3
Basic Financial Statements:	
Statements of Net Position, June 30, 2014 and 2013	8
Statements of Revenue, Expenses, and Changes in Net Position, Years ended June 30, 2014 and 2013	9
Statements of Cash Flows, Years ended June 30, 2014 and 2013	10
Notes to Financial Statements	11
<b>Reports Required by OMB Circular A-133</b>	
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	19
Independent Auditors' Report on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance Required by OMB Circular A-133, <i>Audits of States, Local Governments, and Non-Profit Organizations</i>	21
Schedule of Expenditures of Federal Awards	23
Notes to Schedule of Expenditures of Federal Awards	24
Schedule of Findings and Questioned Costs	25



KPMG LLP  
500 Capitol Mall, Ste 2100  
Sacramento, CA 95814-4754

## Independent Auditors' Report

Board of Directors  
California Health Benefit Exchange

### Report on the Financial Statements

We have audited the accompanying financial statements of the California Health Benefit Exchange (Covered California) as of and for the years ended June 30, 2014 and 2013 and the related notes to the financial statements, which collectively comprise Covered California'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 U.S. generally accepted accounting principles; 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.

### *Auditors' Responsibility*

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether 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 opinion.

### *Opinion*

In our 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.



**Other Matters**

*Required Supplementary Information*

U.S. generally accepted accounting principles require that the management’s discussion and analysis on pages 3-7 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.

*Supplementary and Other Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Covered California’s basic financial statements. The accompanying schedule of expenditures of federal awards, as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2015 on our consideration of Covered California’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 Covered California’s internal control over financial reporting and compliance.

**KPMG LLP**

Sacramento, California  
March 27, 2015

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

Management's Discussion and Analysis (Unaudited)

June 30, 2014 and 2013

The following discussion and analysis of the California Health Benefit Exchange's (Covered California or Exchange) financial performance provides an overview of financial activities for the fiscal years ended June 30, 2014 and 2013. Please read it in conjunction with Covered California's financial statements that follow this section.

**Financial Statements**

These required statements offer short-term and long-term financial information about Covered California. The statement of net position provides information about the nature and amounts of investments in resources (assets) and obligations (liabilities) at the close of the fiscal year. All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses, and changes in net position. This statement measures Covered California's operations over the past year. The final required financial statement is the statement of cash flows. The primary purpose of this statement is to provide information about Covered California's cash receipts and cash payments during the reporting period. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities, and provides answers to such questions as where did cash come from and what was cash used for. The financial statements are prepared on the accrual basis in accordance with U.S. generally accepted accounting principles.

**Notes to Financial Statements**

The notes provide additional information that is essential to the full understanding of the data provided in the financial statements. The notes to financial statements can be found on pages 11 through 18 of this report.

**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>

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

Management's Discussion and Analysis (Unaudited)

June 30, 2014 and 2013

**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>

*Fiscal Year 2014*

**Financial Highlights**

Covered California continues to rely on federal grant funding for its operations. Since September 2010, Covered California has been awarded grants totaling \$1.1 billion to establish the organization and operate through December 2014. However, Covered California has received federal approval to roll over unspent grant funds to calendar year 2015 to cover establishment expenditures through December 2015. Under the statute that established Covered California, it cannot rely on State of California general funds to support operations and, starting January 1, 2015, upon the expiration of authority to spend federal grant funds, it must be fully self-sufficient based on revenue raised in its operations. However, as stated above, Covered California will have the ability to spend federal grant funds that rolled over to calendar year 2015. In accordance with state law, Covered California assessed enrollment fees on health insurance companies for policies sold to individuals and small businesses. Enrollment of approximately 1.4 million individuals through Covered California during the first Open Enrollment period (October 1, 2013–March 31, 2014) was achieved. Funding for the fiscal year ended June 30, 2014 includes federal grant funds and monthly fees assessed on qualified 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.

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

Management's Discussion and Analysis (Unaudited)

June 30, 2014 and 2013

Fiscal year 2013-14 was the second full year of operations for Covered California. Similar to fiscal year 2012-13, during fiscal year 2013-14 the timing of significant expenditures occurred later than originally anticipated, which resulted in a delay of some expenditures to fiscal year 2014-15.

Covered California's total net position increased by \$188.3 million in fiscal year 2014 and increased by \$119.9 million in fiscal year 2013 over prior fiscal year. The increase in fiscal year 2014 over the prior fiscal year was due to additional cash required from federal grant drawdowns to cover incurred operating and capital expenses to continue establishing the Exchange, and also from operating revenues from enrollment fees from health insurance carriers. The increase in fiscal year 2013 over the prior fiscal year was due to increased cash required from federal grant drawdowns to cover incurred operating and capital expenses related to establishing the Exchange, including the design and development of the information technology infrastructure, promoting the Exchange products, and establishing and staffing the Service Center.

Covered California's total net investment in capital assets were \$247.2 million and \$122.4 million at June 30, 2014 and 2013, respectively. The increase in fiscal year 2014 of 102% over the 2013 fiscal year was due to the continued effort to develop and implement the California Healthcare Eligibility, Enrollment and Retention System (CalHEERS). The increase in fiscal year 2013 over the prior fiscal year was primarily due to the design and development of CalHEERS. In fiscal year 2014 and 2013, \$149.4 million and \$119.4 million of expenses have been capitalized as internally generated computer software, respectively. CalHEERS was put into use on October 1, 2013 and therefore the depreciation of the system started in fiscal year 2014. Additional costs will be capitalized and depreciated as Covered California moves towards final system acceptance.

Covered California's assets exceeded liabilities by \$307.9 million and \$119.6 million at the close of the fiscal years ended June 30, 2014 and 2013, respectively. In fiscal year 2014, total current assets included grants receivable of \$65.6 million due from the Federal government, enrollment fee receivables of \$65.4 million due from health insurance carriers, and receivables from other state agencies of \$27.0 million for reimbursements due from the Department of Health Care Services. Capital assets included the capitalized cost required for the development and implementation of CalHEERS as well as office furniture and equipment and leasehold improvements. Current liabilities included accounts payable for unpaid goods and services of \$110.4 million. In fiscal year 2013, current and other assets included grants receivable of \$14.6 million due from the Federal government, and receivables from other state agencies of \$17.0 million for reimbursements due from the Department of Health Care Services. Capital assets included the capitalized cost required for the design and development of CalHEERS as well as office furniture and equipment and leasehold improvements. Current liabilities included accounts payable for unpaid goods and services of \$49.8 million.

*Fiscal Year 2013*

**Financial Highlights**

Covered California continues to rely on federal grant funding for its operations. Since September 2010, Covered California has been awarded grants totaling \$1.1 billion in federal funding to establish the organization and operate through December 2014. Under the statute that established Covered California, it cannot rely on State of California general funds to support operations. Starting January 1, 2015, upon the expiration of authority to spend federal grant funds, it must be fully self-sufficient based on revenue raised in its operations.

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

Management's Discussion and Analysis (Unaudited)

June 30, 2014 and 2013

Covered California expenditures in fiscal year 2012-13 focused on 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.

**Financial Statements**

These required statements offer short-term and long-term financial information about Covered California. The statement of net position provides information about the nature and amounts of investments in resources (assets) and obligations (liabilities) at the close of the fiscal year. All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses, and changes in net position. This statement measures the success of Covered California's operations over the past year. The final required financial statement is the statement of cash flows. The primary purpose of this statement is to provide information about Covered California's cash receipts and cash payments during the reporting period. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities, and provides answers to such questions as where did cash come from and what was cash used for. The financial statements are prepared on the accrual basis in accordance with U.S. generally accepted accounting principles.

**Capital Assets**

During fiscal year 2012-13, Covered California began development of CalHEERS, which is an automated system that serves as the consolidated system support for eligibility, enrollment, and retention for the exchange, Medi-Cal, and Healthy Families. As of June 30, 2013, \$119.4 million of expenses have been capitalized as internally generated computer software.

*Fiscal Year 2015*

**Economic Outlook**

Covered California has been working since it was established in 2010 to lay the groundwork for the dramatic expansion of coverage that will benefit millions of Californians starting in 2014. Covered California has made, and continues to make progress through accelerated planning, development, and implementation activities.

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 resulting in increased competition in the individual insurance market. More than 83 percent of Covered California enrollees benefited from receiving federal subsidies to lower premium costs. Looking ahead to 2015, Covered California will offer good products at good prices. Covered California selected 10 health insurance companies to offer coverage in 2015. Preliminary rates reflect an average increase of only 4.2 percent, and most of those consumers who receive subsidies are likely to see their subsidy stay the same or increase in 2015.

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

Management's Discussion and Analysis (Unaudited)

June 30, 2014 and 2013

Covered California is actively engaged in ongoing policy development, government relations, and legal functions to support ongoing implementation activities. Because of the dynamic and evolving nature of implementation activities, including rules and regulations associated with establishing a state-based Exchange, ongoing engagement in this core area is critical to long-term sustainability. Covered California continues to monitor federal and state regulations and guidance to ensure compliance with new regulations.

Given the state's profile, Covered California engaged in early research on target audiences; careful examination of experiences with other public and private health coverage providers; and a great deal of collaboration and input from insurance agents and community stakeholders, private foundations, health plans, experts, and influencers. This intense research pointed to the need for a multichannel, multicultural marketing, outreach, education, and enrollment assistance effort anchored in local communities across the state.

Covered California implemented an Outreach and Education Grant Program (O&EGP) to promote public awareness and to inform consumers and small businesses about their options to obtain affordable health coverage through Covered California. This program provides consumers and small businesses with information and tools so that individuals and employers may enroll on their own.

Covered California has been implementing a multiyear, multiethnic, multilanguage outreach, marketing, public awareness, and enrollment assistance program. Campaigns will continue through the second open enrollment 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.

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 in coverage in the exchange. The second open enrollment period campaign will build on and benefit from the experiences gained during the first open enrollment, but it will reflect new challenges as it includes the first ever program to encourage those who did enroll to renew their coverage, while seeking to reach more Californians who are uninsured.

Covered California implemented a centralized multisite service center model. The service center plays a critical role in achieving Covered California's goal of maximizing enrollment of eligible individuals and small employers.

At the Board's June 2014 meeting, it adopted its fiscal year 2014-15 budget, authorizing operational expenditures of \$442.8 million. Expenditures will be primarily devoted to promoting and facilitating retention and new enrollment. Sales enrollment activities, including outreach and communications, and Service Center operations will account for more than half of the fiscal year 2014-15 projected expenditures.

**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

See accompanying notes to financial statements.

**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>

See accompanying notes to financial statements.

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

Statements of Cash Flows

Years ended June 30, 2014 and 2013

	<b>2014</b>	<b>2013</b>
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	(252,993,553)	(1,570,605)
Net cash used in operating activities	(299,169,966)	(8,221,779)
Cash flows from noncapital financing activities:		
Operating grants	283,964,916	12,935,801
State - reimbursements	16,379,865	—
Net cash provided by noncapital financing activities	300,344,781	12,935,801
Cash flows from capital and related financing activities:		
Capital grants	113,387,251	119,794,960
Acquisition of capital assets	(111,521,908)	(107,687,467)
Net cash provided by capital and related financing activities	1,865,343	12,107,493
Cash flows from investing activities:		
Interest income	12,445	16,887
Net increase in cash and cash equivalents	3,052,603	16,838,402
Cash and cash equivalents – beginning of year	18,296,555	1,458,153
Cash and cash equivalents – end of year	\$ 21,349,158	18,296,555
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	1,363,619	125,482
Net cash used in operating activities	\$ (299,169,966)	(8,221,779)

See accompanying notes to financial statements.

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

Notes to Financial Statements

June 30, 2014 and 2013

**(1) Summary of Significant Accounting Policies**

**(a) Organization**

The California Health Benefit Exchange (Covered California) was created on September 30, 2010 as an independent public entity with the passage of Assembly Bill 1602, enacting the federal Patient Protection and Affordable Care Act (Affordable Care Act). Under the Affordable Care Act signed into law in March of 2010, states were required to decide whether to create a state-based health insurance exchange or participate in the federal multistate health insurance exchange. The State of California (the State) elected to establish a state-based health insurance exchange. In 2010, State law was enacted to implement the provisions of the Affordable Care Act to reduce the number of uninsured Californians by creating an organized, transparent marketplace for Californians to purchase affordable, quality healthcare coverage offered in four categories, or tiers, each with a metal rating of Bronze, Silver, Gold, and Platinum.

Covered California is not a component unit of the State. Covered California is a related organization.

**(b) Basis of Presentation**

The financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles. Under this method, revenues are recorded when earned and expenses are recorded when the related liability is incurred.

**(c) Revenue Recognition**

Revenues are classified as operating or nonoperating in the accompanying Statements of Revenue, Expenses and Changes in Net Position. Operating revenues began in fiscal year 2013-2014, and result from providing services in connection with the ongoing operations and include monthly enrollment fees assessed on health insurance companies for policies sold through the marketplace for individual and Small Business Health Options Program (SHOP) programs.

In the individual market, Covered California charges the health insurance carriers a per-member-per-month fee, which is set annually for effectuated members. For fiscal year 2013-2014, the per-member-per-month fee was \$13.95 per medical enrollee and \$0.83 per dental enrollee.

In the SHOP market, Covered California charges the health insurance carriers a per-member-per-month fee, which is set annually for effectuated members. For fiscal year 2013-2014, the per-member-per-month fee was \$18.60 per medical enrollee and \$.83 per dental enrollee.

Covered California recognizes individual and SHOP enrollment fee revenues when effectuated enrollment occurs and the fees are earned from the health insurance carriers. All revenues received that are not part of the ongoing operations, such as capital and operating assistance grants and interest income, are classified as nonoperating revenues.

**(d) Cash and Cash Equivalents**

Cash and cash equivalents represent cash deposited in the Surplus Money Investment Fund (SMIF) and cash on hand with the State Treasurer.

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

Notes to Financial Statements

June 30, 2014 and 2013

**(e) Receivables**

Grants receivable represents amounts owed from the Federal government.

Accounts receivable represents amounts owed by the California Department of Health Care Services for its share of the costs related to California Healthcare Eligibility, Enrollment, and Retention System (CalHEERs) of \$27 million and \$17 million for the years ended June 30, 2014 and 2013, respectively. It also represents amounts outstanding from enrollment fees of \$65.4 million, which is net of a 9.5% allowance totaling \$6.7 million, and amounts due from employees of \$71,500.

**(f) Capital Assets**

Capital assets are defined as assets which have a unit cost of \$5,000 or greater and a useful life of more than one year. Capital assets are stated at cost. Depreciation on equipment is calculated using the straight-line method over the estimated useful life ranging from 2 to 20 years. Depreciation on internally generated software and purchased software is calculated using the straight-line method over the estimated useful life of 10 and 5 years, respectively. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in the period of disposal. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the lease term or the useful life.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 51, *Accounting and Reporting for Intangible Assets*, Covered California has recorded internally generated computer software that is in the development stage; however, the system went live on October 1, 2013. Intangible assets are considered internally generated if they are created or produced by the department or an entity contracted by the department, or if they are acquired from a third party but require more than minimal incremental effort on the part of the department to begin to achieve their expected level of service capacity. The preliminary project stage was completed in June 2012. Application development costs incurred from July 2012 through June 30, 2013 were \$119.4 million and from July 2013 through June 30, 2014 were \$149.4 million. Depreciation of the assets began on October 1, 2013, and totaled \$24.8 million for fiscal year 2014.

**(g) Compensated Absences Payable**

Vacation balances are accrued as a liability as earned.

**(h) Commissions Fees**

Covered California entered into a contract with Department of Healthcare Services (DHCS) whereby DHCS compensates certified enrollment entities and agents for successful consumer enrollment and effectuation in Medi-Cal. The compensation is either \$58 or \$29 depending on enrollment factors.

**(i) Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial

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

Notes to Financial Statements

June 30, 2014 and 2013

statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*(j) Reclassification*

Certain reclassifications not affecting net income have been made to the June 30, 2013 consolidated financial statements to conform to the June 30, 2014 presentation.

**(2) Cash and Cash Equivalents**

Cash and cash equivalents are held as cash on hand in pools and managed by the State Treasurer. They are not evidenced by securities. Interest income earned on outstanding cash balances is allocated among pool participants based on average daily cash balances.

	<b>2014</b>	<b>2013</b>
State treasury	\$ 6,202,158	9,331,555
Surplus money investment fund	15,147,000	8,965,000
Total	\$ 21,349,158	18,296,555

As of June 30, 2014 and 2013, the carrying value of deposits in the SMIF represents the fair value. The SMIF consists of available cash and all special funds of the State which do not have investment authority of their own. Cash balances in excess of needs in any of these participating funds are invested by the State Treasurer. The Pooled Money Investment Board (PMIB) provides regulatory oversight over the State Treasurer's pooled investment program and is responsible for determining whether any cash balances of the participating funds are in excess of current needs and available for investment, or whether it is necessary to liquidate previous investments to meet current requirements. The PMIB is composed of the State Treasurer, as chairman; the State Controller; and the Director of Finance for the State.

All of the resources of the SMIF are invested through the Pooled Money Investment Account (PMIA). By law, PMIA monies can be invested only in the following categories: U.S. Government securities; securities of federally sponsored agencies; domestic corporate bonds; interest-bearing time deposits in California banks, savings and loan associations, and credit unions; prime-rated commercial paper; repurchase and reverse repurchase agreements; security loans; banker's acceptances; negotiable certificates of deposits; and loans to various bond funds.

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

Notes to Financial Statements

June 30, 2014 and 2013

**(3) Capital Assets**

Changes in capital assets for the year ended June 30, 2014 are as follows:

	<b>Balance July 1, 2013</b>	<b>Increases</b>	<b>Decreases</b>	<b>Balance June 30, 2014</b>
Depreciable assets-development costs:				
Internally developed software	\$ 82,955,134	124,424,743	—	207,379,877
Hardware	14,304,063	7,468,197	—	21,772,260
Licenses and purchased software	22,093,886	17,473,579	—	39,567,465
Total depreciable assets development costs	<u>119,353,083</u>	<u>149,366,519</u>	<u>—</u>	<u>268,719,602</u>
Depreciable capital assets:				
Office furniture and equipment	2,909,666	757,606	(201,670)	3,465,602
Leasehold improvements	116,039	265,832	—	381,871
Total depreciable capital assets	<u>3,025,705</u>	<u>1,023,438</u>	<u>(201,670)</u>	<u>3,847,473</u>
Less accumulated depreciation:				
Asset development costs	—	(24,754,450)	—	(24,754,450)
Office furniture and equipment	(5,393)	(580,069)	—	(585,462)
Leasehold improvements	(15,196)	(33,766)	—	(48,962)
Total accumulated depreciation	<u>(20,589)</u>	<u>(25,368,285)</u>	<u>—</u>	<u>(25,388,874)</u>
Total capital assets, net	<u>\$ 122,358,199</u>	<u>125,021,672</u>	<u>(201,670)</u>	<u>247,178,201</u>

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

Notes to Financial Statements

June 30, 2014 and 2013

Changes in capital assets for the year ended June 30, 2013 are as follows:

	<u>Balance</u> <u>July 1, 2012</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2013</u>
Nondepreciable capital assets:				
Internally developed software	\$ —	82,955,134	—	82,955,134
Hardware	—	14,304,063	—	14,304,063
Licenses and purchased software	—	22,093,886	—	22,093,886
Total nondepreciable assets development costs	—	119,353,083	—	119,353,083
Depreciable capital assets:				
Office furniture and equipment	31,876	2,877,790	—	2,909,666
Leasehold improvements	—	116,039	—	116,039
Total depreciable capital assets	31,876	2,993,829	—	3,025,705
Less accumulated depreciation:				
Office furniture and equipment	—	(5,393)	—	(5,393)
Leasehold improvements	—	(15,196)	—	(15,196)
Total accumulated depreciation	—	(20,589)	—	(20,589)
Total capital assets, net	\$ 31,876	122,326,323	—	122,358,199

**(4) Leases**

Covered California leases office space for its headquarters, Service Center, and training facilities under operating leases. The lease terms vary, with the oldest expiring April 30, 2022.

The future minimum lease payments under operating leases as of June 30, 2014 are as follows:

For the year ending June 30:	
2015	\$ 5,857,489
2016	5,993,717
2017	6,100,158
2018	6,236,386
2019	6,342,828
Thereafter	12,386,761

Rental expense for operating leases totaled \$3.4 million and \$743,500 for the years ended June 30, 2014 and 2013, respectively.

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

Notes to Financial Statements

June 30, 2014 and 2013

**(5) Retirement Planning And Other Postemployment Benefits**

**(a) Retirement Plan**

Covered California contributes to the Public Employees' Retirement Fund administered by the California Public Employees Retirement System (CalPERS), an agent multiple-employer public employee defined benefit pension plan. CalPERS provides retirement benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public entities within the State and uses the accrual basis of accounting. Benefit provisions and all other requirements are established by state statute. Since all state agencies, including Covered California, are considered collectively to be a single employer, the actuarial present value of vested and nonvested accumulated plan benefits attributable to the Covered California's employees cannot be determined. Similarly, the net position available for benefits of Covered California employees cannot be determined.

CalPERS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. CalPERS' annual financial report may be obtained by writing to the California Public Employees' Retirement System, Fiscal Services Division, P.O. Box 942703, Sacramento, California 94229 or by visiting the CalPERS Web site at [www.CalPERS.ca.gov](http://www.CalPERS.ca.gov).

Generally, full-time employees are eligible to participate as members of CalPERS and are eligible to retire at age 50 with at least five years of service or age 55 with at least 10 years of service depending on the plan selected by the employee. However, the Public Employees' Pension Reform Act, or PERA, was passed in 2012 and went into effect on January 1, 2013. This new law changed the terms of the pension plan for state workers first hired after January 1, 2013. Annual retirement benefits are determined based on age at retirement, the length of membership service, and the amount of earnings based on the highest or last 12 or 36 consecutive months' average compensation. Healthcare and dental benefits may be provided to members depending on the date hired and the years of credited service of a member. If members are not fully vested, the healthcare and dental contributions will be prorated based on the years of service.

Active plan members are required to contribute a percentage of their salary depending on their plan selection and employment classification. Employees' required contributions vary in amounts up to 11.0%. Covered California is required to contribute at an actuarially determined rate. Covered California's contributions are based on a percentage of annual covered payroll depending on the plan selected and member status. For the years ended June 30, 2014 and 2013, Covered California's payroll for employees covered by CalPERS was approximately \$51.7 million and \$9.2 million, respectively and the total payroll for the periods was approximately \$53.3 million and \$9.2 million, respectively. The contribution requirements of plan members and the Covered California are established and may be amended by CalPERS. Required employer contribution rates (expressed as a percentage of compensation) for the fiscal years ended June 30, 2014 and 2013 are as follows:

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

Notes to Financial Statements

June 30, 2014 and 2013

	<b>2014</b>	<b>2013</b>
State Miscellaneous Member First Tier	21.12%	20.50%
State Miscellaneous Member Second Tier	20.99%	20.46%

Covered California’s pension cost for the year ended June 30, 2014 and 2013, was equal to Covered California’s required contributions which were determined as part of the most recent actuarial valuation performed by CalPERS dated June 30, 2013.

Three-year trend information for Covered California is as follows:

<b>Fiscal Year Ended</b>	<b>Annual Pension Cost (APC)</b>	<b>Percentage of APC Contributed</b>	<b>Net Pension Obligation</b>
6/30/12	\$ 141,308	100%	—
6/30/13	1,041,768	100%	—
6/30/14	4,797,071	100%	—

**(b) Other Postemployment Benefits**

Postretirement healthcare benefits are also provided to Covered California employees through the programs sponsored by the State as administered by CalPERS and the Department of Personnel Administration (DPS). As the postretirement healthcare plan is sponsored by the State, it is considered a single-employer plan.

Healthcare and dental benefits may be provided to members depending on the date hired and the member’s years of credited services. Postretirement health benefits include medical, prescription drug, and dental benefits and are currently funded on a pay-as-you-go basis. Employer contributions for health premiums during fiscal year 2013-14 maintained the 100/90 percent contribution formula established by Government Code. Under this formula, the State uses 100 percent of the weighted average premiums of the four largest health benefit plans in order to calculate the maximum amount the State will contribute toward the retiree’s health benefits. The State also contributes 90 percent of this average for the health benefits of each of the retiree’s dependents. The retiree is responsible for paying all health benefit plan costs that exceed the average of the four largest benefit plans. The monthly contribution maximums are \$642 for a single enrollee, \$1,218 for an enrollee and one dependent, and \$1,559 for an enrollee and two or more dependents. Dental premiums vary by plan and number of dependents. The contribution formulas are subject to approval and amendment by the legislature of the State. If members are not fully vested, the healthcare and dental contributions will be pro rated based on the years of service.

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

Notes to Financial Statements

June 30, 2014 and 2013

Covered California paid approximately \$1.1 million and \$125,000 for postretirement health and dental benefits for retired members for the years ended June 30, 2014 and 2013, respectively. Covered California has adopted GASB Statement No. 45 and has a net OPEB obligation (NOO). Covered California's annual OPEB cost (AOC) is calculated based on the annual required contribution (ARC). The AOC recorded by Covered California is calculated by the State and represents an allocation of the total ARC of the State, adjusted for interest and other adjustments. The allocation is based on Covered California's retiree health costs in relation to the total State retiree health costs. The ARC represents normal cost plus an amortization of the difference between the actuarial accrued liability and any asset available to pay benefits. The AOC for the years ended June 30, 2014 and 2013 was \$1.6 million and \$192,900, respectively. The total NOO liability recorded as of June 30, 2014 and 2013 was \$1.1 million and \$125,000 respectively.

The actuarial valuation report for OPEB can be obtained by writing to the Office of the State Controller, John Chiang, P.O. Box 942850, Sacramento, California 94250 or by visiting the State Controller's website at [www.SCO.ca.gov](http://www.SCO.ca.gov).

**(6) Commitments and Contingencies**

As of June 30, 2014, Covered California has outstanding commitments of \$27.1 million related primarily to information technology projects.

Covered California receives federal awards. Receipts from federal grants are subject to audit to determine if the funds were expended in accordance with appropriate statutes, grant terms, and regulations. Any disallowed expenditures resulting from such audits become a liability of Covered California. Management does not believe such adjustments, if any, would materially affect the financial condition or operations of Covered California.

**(7) Risk Management**

Covered California is self-insured through the State Department of General Services (DGS) Office of Risk and Insurance Management (ORIM) for risks of employee errors and omissions, business interruption, and comprehensive insurance. The ORIM provides risk management and insurance services to state and other public entities on an ongoing or project-specific basis. There have been no significant reductions in insurance coverage from the prior year. In addition, no insurance settlement in the last three years has exceeded insurance coverage. All claims are on a "pay-as-you-go" basis.

Liabilities for workers' compensation costs are accrued based on estimates derived from the State Compensation Insurance Fund. This estimate is based on actuarial reviews of employee workers' compensation program and includes indemnity payments compensation benefits and leave benefits. The liability for workers' compensation is not material to the financial statements as a whole.



KPMG LLP  
500 Capitol Mall, Ste 2100  
Sacramento, CA 95814-4754

**Independent Auditors' 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***

Board of Directors  
California Health Benefit Exchange

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 the California Health Benefit Exchange (Covered California), which comprise the statement of financial position as of June 30, 2014, and the related statements of revenues, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 27, 2015.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Covered California'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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Covered California's internal control. Accordingly, we do not express an opinion on the effectiveness of Covered California'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 deficiency, or 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. 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 consider the deficiency described as 2014-001 in the accompanying schedule of findings and questioned costs to be a significant deficiency.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Covered California's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance



with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

**Covered California’s Response to the Finding**

Covered California’s response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. Covered California’s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

**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 Covered California’s internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Covered California’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

**KPMG LLP**

Sacramento, California  
March 27, 2015



KPMG LLP  
500 Capitol Mall, Ste 2100  
Sacramento, CA 95814-4754

**Independent Auditors' Report on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance Required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations***

Board of Directors  
California Health Benefit Exchange

**Report on Compliance for Each Major Federal Program**

We have audited the California Health Benefit Exchange's (Covered California) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on Covered California's major federal program for the year ended June 30, 2014. Covered California's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

***Management's Responsibility***

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

***Auditors' Responsibility***

Our responsibility is to express an opinion on compliance for Covered California's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our 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*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Covered California's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of Covered California's compliance.

***Opinion on Each Major Federal Program***

In our opinion, Covered California complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2014.



## Report on Internal Control Over Compliance

Management of Covered California is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Covered California's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Covered California's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

**KPMG LLP**

Sacramento, California  
March 27, 2015

**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

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

Notes to Schedule of Expenditures of Federal Awards

June 30, 2014

**(1) Basis of Accounting**

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) is presented on the accrual basis.

**(2) Relationship to Federal Financial Reports**

The regulations and guidelines governing the preparation of federal financial reports vary by federal agency and among programs. Accordingly, the amounts reported in the federal financial reports do not necessarily agree with the amounts reported in the accompanying Schedule, which is prepared on the basis explained in Note 1.

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

Schedule of Findings and Questioned Costs

June 30, 2014

**(1) Summary of Auditors' Results**

A. The type of report issued on the financial statements: **Unmodified opinion**

B. Material weaknesses: **None**

Significant deficiencies in internal control disclosed by the audit of the financial statements: **Yes**

C. Noncompliance that is material to the financial statements: **None**

D. Significant deficiencies in internal control over major program: **None**

Material weaknesses: **None**

E. The type of report issued on compliance for the major program: **Unmodified opinion**

F. Any audit findings that are required to be reported under Section 0.510(a) of OMB Circular A-133: **None**

G. Major program:

93.525                      State Planning and Establishment Grants for the Affordable Care Act (ACA)'s Exchanges

H. Dollar threshold used to distinguish between Type A and Type B programs: **\$3,000,000**

I. Auditee qualified as a low-risk auditee under Section 0.530 of OMB Circular A-133: **No**

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

Schedule of Findings and Questioned Costs

June 30, 2014

**(2) Financial Statement Findings Section**

Reference Number: 2014-001

During our audit for fiscal year 2012-13, we reported that Covered California lacked adequate controls to ensure its financial statements were accurate and complete. During fiscal year 2013-2014, Covered California improved its processes to record capital assets, accounts payable, and grants receivable. However, we found Covered California could further improve its controls to ensure the financial statements are fairly presented. During our audit, we found that Covered California does not have adequate controls in place to review top-side journal entries made to report amounts in accordance with generally accepted accounting principles. We identified the following errors in the financial statements which were corrected by Covered California.

*Revenue:*

From inception through October 2013, federal grants have been Covered California's sole revenue source. In October 2013, enrollment for health benefit exchange programs commenced and Covered California began collecting and recognizing enrollment fee revenue for two distinct revenue sources: Individuals and Small Business Health Options Program (SHOP). During our audit, we found that Covered California did not have adequate controls in place to prevent or detect an error in billing for enrollment fees and collecting payments. We specifically noted the following as it relates to enrollment fee 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.

**Recommendations**

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

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

Schedule of Findings and Questioned Costs

June 30, 2014

- Evaluate individual invoices to ensure proper capitalization of the CalHEERS costs
- Evaluate invoices with DHCS to ensure the revenue and receivable balances are accurately reported.

**Covered California's View and Corrective Action Plan**

*Revenue:*

Covered California's Response to Recommendation No. 1:

- We concur with this finding. Covered California has already taken action to ensure SHOP payments are applied. These actions include establishment of a new section, Accounting Systems Resolution Section within the Financial Management Division (FMD), to apply cash and properly reflect SHOP revenue and accounts receivable on a timely basis. This new unit was created in FY 14-15 to assist with the workload related to revenue billing and partner payments. FMD in cooperation with system vendors, has created new reports and processes to assist in the revenue receipts and partner payments.

Covered California's Response to Recommendation No. 2:

- We concur with this finding. Covered California has already taken action to ensure per member per month fees are accurately billed. These actions include establishment of a new section, Accounting Systems Resolution Section within FMD, to ensure revenue and the associated allowance for non-effectuated members is properly reflected. This new unit was created in FY 14-15 to assist with the workload related to revenue billing and partner payments.

*Other Financial Statement Items:*

Covered California's Response to Recommendation No. 1:

- We concur with this finding. The FMD will continue to work closely with CalHEERS to ensure proper capitalization of the CalHEERS costs. On a monthly basis, FMD will continue to evaluate invoices to ensure proper capitalization of the CalHEERS costs.

Covered California's Response to Recommendation No. 2:

- We concur with this finding. The FMD will continue to work closely with DHCS to ensure revenue and receivable balances are properly reported and invoices are received in a timely manner. FMD will set up a procedure to evaluate all payments received and the outstanding amounts to ensure revenue and receivables are properly reflected on the financial statements. At year-end, the FMD will include a procedure to adjust the GAAP financial statements to properly record all DHCS revenue and receivable balances.

**Contact**

Jim Lombard, Chief Financial Officer

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

Schedule of Findings and Questioned Costs

June 30, 2014

**Implementation Date**

Implementation began on July 1, 2014

**(3) Federal Awards Findings Section**

None