

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

Financial Statements with Independent Auditors' Report

Year ended June 30, 2017

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

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
California Health Benefit Exchange
Sacramento, California

Report on the Financial Statements

We have audited the accompanying financial statements of California Health Benefit Exchange (Covered California) as of and for the year ended June 30, 2017, 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 accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Covered California as of June 30, 2017, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.



To the Board of Directors
California Health Benefit Exchange
Sacramento, California

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, the schedule of proportionate share of Net Pension Liability and the schedule of plan contributions 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 25, 2018, on our consideration of the 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.

Lance, Soll & Lughard, LLP

Brea, California
April 25, 2018

**CALIFORNIA HEALTH BENEFIT EXCHANGE
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Management's Discussion and Analysis (Unaudited)

June 30, 2017

The following discussion and analysis of the California Health Benefit Exchange's (Covered California) financial performance provides an overview of financial activities for the fiscal year ended June 30, 2017. 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 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.

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 17 through 29 of this report.

The required supplementary information section includes pension schedules, related to Covered California's proportionate share of net pension liability and pension contributions, as required by GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*.

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June 30, 2017

Condensed Summary of Net Position

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

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Current and other assets	\$ 392,992,988	390,563,418
Capital assets	<u>201,261,120</u>	<u>228,884,477</u>
Total assets	<u>594,254,108</u>	<u>619,447,895</u>
Deferred outflows of resources	34,903,415	16,277,279
Total assets and deferred outflows of resources	629,157,523	635,725,174
Current liabilities	50,050,960	51,784,434
Noncurrent liabilities	32,596,892	19,306,855
Net pension liability	<u>165,589,315</u>	<u>121,049,500</u>
Total liabilities	<u>248,237,167</u>	<u>192,140,789</u>
Deferred inflows of resources	380,221	2,642,443
Total liabilities and deferred outflows of resources	248,617,388	194,783,232
Investment in capital assets	201,261,120	228,884,477
Unrestricted	<u>179,279,015</u>	<u>212,057,465</u>
Total net position	<u>\$ 380,540,135</u>	<u>440,941,942</u>

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June 30, 2017

Condensed Summary of Changes in Net Position

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

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Operating revenues	\$ 263,241,195	224,124,047
Operating expenses	<u>326,299,656</u>	<u>357,075,624</u>
Operating loss	(63,058,461)	(132,951,577)
Nonoperating revenue	<u>2,656,654</u>	<u>146,512,773</u>
Income before capital contributions	(60,401,807)	13,561,196
Capital contributions	<u>-</u>	<u>15,040,848</u>
Changes in net position	(60,401,807)	28,602,044
Total net position – beginning of year, as previously stated	440,941,942	390,153,814
Prior period adjustment	<u>-</u>	<u>22,186,084</u>
Total net position – beginning of year, as restated	440,941,942	-
Total net position – end of year	<u>\$ 380,540,135</u>	<u>440,941,942</u>

The prior period net position for the fiscal year 2015-16 was adjusted to properly reflect the reconciliation of grant revenue.

Fiscal Year 2016-17

Financial Highlights

Covered California's funding for the fiscal year ended June 30, 2017 included our last draw of federal grant funds and monthly fees assessed on qualified health plans. The Board approved budget incorporated resources to transition from federal establishment funds to operating funds generated from plan assessments as envisioned by the Affordable Care Act and the legislative intent behind California establishing an independent and financially self-sufficient state-based marketplace. Covered California was awarded grants totaling \$1.1 billion to establish and operate the organization through December 2014. However, Covered California received federal approval to use unspent grant funds for establishment expenditures through September 30, 2016. The approval of the federal grant extension gave Covered California more time to establish the organization as it worked toward its goal of establishing the most efficient and cost-effective structure possible. The remaining grant funds were spent in the 2015-2016 fiscal year.

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Under the statute that established Covered California, it cannot rely on State of California General Funds to support operations. Fiscal year 2016-17 marks the first year Covered California relied solely on fee revenue collected from health plans. In accordance with state law, Covered California assesses enrollment fees on health insurance companies for policies sold to individuals and small businesses.

For FY 2016-17, Covered California's budget and expenditures were aligned with the overall mission and vision, as well as with our strategic pillars:

- Affordable Plans – Consumers purchase and keep Covered California products based on their perception that this is a good value for them.
- Getting Needed Care – Consumers receive the right care at the right time.
- Outreach and Education – Consumers understand what Covered California offers and have a positive attitude about Covered California.
- Positive Consumer Experience – Consumers have a positive experience from initial enrollment to keeping their coverage.
- Organizational Excellence – Covered California has the right tools, processes and resources to support its team to deliver on the exchange's mission.

The expenditures in Budgetary Legal basis for FY 2016-17 are lower than the Board approved budget of \$320.9 million. This is primarily the result of lower-than-budgeted expenditures in all functional areas, in particular in the Service Center, in Outreach, Sales and Marketing, in Administration and in Technology.

Expenditure Summary by Major Areas

- Service Center — expenditures of \$83.0 million for FY 2016-17 were \$9.2 million lower than budgeted, primarily due to \$6.4 million in salary savings from vacant positions, in conjunction with general expense and contract expenditures that were \$2.8 million lower-than-expected.
- Outreach, Sales and Marketing — expenditures of \$92.9 million for these programs in FY 2016-17 were \$11.2 million lower than budgeted, largely due to salary savings and lower-than-expected contract expenditures.
- Plan Management and Evaluation — expenditures of \$11.5 million were \$4.4 million lower-than-budgeted, due to salary savings and lower-than-anticipated contract expenditures.
- Administration — expenditures of \$31.8 million were \$10.1 million lower than the FY 2016-17 budget largely due to salary savings and lower-than-expected contract expenditures across all Administration divisions.
- Technology — expenditures of \$57.2 million were \$9.7 million lower than budgeted. Expenditures for CalHEERS, including the Statewide Automated Welfare System (SAWS) interface and expenditures for the Information Technology (IT) Division were \$9.7 million lower due to salary savings and the timing of IT and CalHEERS initiatives.

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Covered California's total net position decreased by \$60.4 million in FY 2016-17. The decrease in FY 2016-17 over the prior fiscal year was due to the end of federal funds.

Covered California's total net investment in capital assets was \$201.3 million and \$228.9 million at June 30, 2017 and 2016, respectively. The decrease in FY 2016-17 of 12 percent over the FY 2015-16 was due to the revised cost allocation methodology for the share of the cost consistent with longstanding federal policy and practice and as set forth in Office of Management and Budget (OMB) Circular A-87, in those cases where Covered California shares functionalities with Medicaid and the Children's Health Insurance Program (CHIP). Those programs are required to pay their share to develop and implement the California Healthcare Eligibility, Enrollment and Retention System (CalHEERS). Previously the cost allocation was 82 percent Covered California and 18 percent Department of Health Care Services (DHCS). The cost allocation was changed to 17.9 percent Covered California and 82.1 percent DHCS effective October 1, 2014. And was again changed to 13.97 percent Covered California and 86.03 percent DHCS effective October 1, 2015, which remained unchanged until October 2017. Covered California's total accumulated depreciation was \$40.8 million and \$38.4 million at June 30, 2017 and 2016, respectively. Additional costs will be capitalized and depreciated as Covered California moves towards final system completion.

Covered California's assets exceeded liabilities by \$380.5 million and \$440.9 million at the close of the fiscal years ended June 30, 2017 and 2016, respectively. In FY 2016-17, total current assets included cash and cash equivalents of \$358 million, enrollment fees receivable of \$32.9 million due from health insurance carriers and small businesses, and receivables from other state agencies of \$.213 million for reimbursements due from the DHCS. Capital assets included the capitalized cost required for the continued implementation of CalHEERS as well as office furniture and equipment and leasehold improvements. Current liabilities included accounts payable for unpaid goods and services of \$39.2 million. Noncurrent liabilities included net pension liability of \$165.6 million.

In FY 2015-16, current and other assets included enrollment fees receivable of \$11.9 million from health insurance carriers and small businesses, and receivables from other state agencies of \$4.2 million for reimbursements due from the DHCS. 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 \$41.1 million.

Enrollment and Revenue Outlook

The current enrollment and revenue forecast in the FY 2017-18 Budget Book was informed by modeling done by PricewaterhouseCoopers (PwC) in partnership with the University of California. The forecast relied on the experience gained from 37 months of active enrollment through the fourth open enrollment period that ended on January 31, 2017. The enrollment activity achieved during this open enrollment was consistent with the FY 2016-17 forecast, which projected that Covered California had entered a phase of stable enrollment. Open enrollment for the 2017 benefit year resulted in enrollment in line with the Base Estimate of approximately 1.4 million enrollees. The Base Estimate used for the FY 2017-18 forecast projected a stable enrollment outlook going forward, but Covered California has modeled alternate enrollment to reflect the uncertainty of the political environment.

Effective January 2017, Covered California's assessment fee switched from a flat per-member-per-month fee to a percentage assessment on total premiums paid. Currently at 4 percent, this fee is being assessed on

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Covered California's 1.4 million enrollees. In addition, there are approximately 800,000 people in the individual market who benefit from the rates negotiated by Covered California, even though they are not directly enrolled through the exchange. The Affordable Care Act requires the rates for these on- and off-exchange plans be the same. Since the specific health plan products offered by Covered California represent approximately 62 percent of the total enrollment in individual coverage, the Affordable Care Act assessment essentially requires the health plans to spread the assessment fee across the entire individual market. To the extent that carriers have members who do not purchase through Covered California, but who pay the same rate, the actual assessment is spread across the entire individual market for those health plans offered by Covered California. With this budget, Covered California will maintain the 4 percent on-exchange assessment, which converts to an estimate that the actual average effective assessment rate is approximately 2.5 percent across the entire individual market.

Forecasting Potential Enrollment

The 2016 enrollment forecast, used for the FY 2016-17 budget, was based on the experience and lessons learned in 2015 as well as insights from the market analysis completed by PwC and the University of California. Adding to these insights, the 2017 forecast reflected the experience of an additional year of enrollment history. Based on the 2016 benefit year and the 2017 open enrollment experience, Covered California's Base Estimate was that it would see stable enrollment going forward.

Individual Market Forecast

The projection in the FY 2017-18 Budget Book begins after the fourth open enrollment period and took into account the following factors:

- The number of new consumers who chose health plans during open enrollment.
- The pace that new enrollees acquired coverage through Covered California during 2016 special enrollment and the likely impact of pre-verification.
- The rate at which enrolled individuals leave Covered California through termination or by failing to renew coverage.
- The likelihood that an individual who selects a plan will pay his or her premium.
- The impact of rising minimum wage on the subsidy-eligible population.
- Potential medical cost trends reflected in premiums.

Forecast Uncertainties

The greatest uncertainties facing Covered California's enrollment and revenue outlook stemmed from major federal legislative or regulatory actions to change key provisions of the Affordable Care Act. During the course of 2017, federal executive action shortened the open enrollment period for the 2018 plan year, reduced the marketing and outreach budget for the 39 states in the federally facilitated marketplace by 90 percent, and ended cost-sharing reduction payments to issuers in October. The 2019 plan year has the potential to be just as uncertain

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and volatile, if not more so. Major policy changes for 2019 include setting the individual mandate tax penalty to zero for plan years 2019 and beyond, potential continuation of the minuscule marketing spending for the federal marketplace and the implementation of association health plans (AHPs) and short-term, limited-duration insurance plans, which could affect the market as early as 2019.

This uncertainty led to reduced carrier participation and the need to make premium work-arounds to address the removal of direct federal funding for the cost-sharing reduction (“CSR”) program. For those receiving subsidies, their premium cost fell on average 3 percent in federally facilitated marketplace (FFM) states, while on average the premium for the lowest-cost Silver plan for those who did not receive subsidies increased 32 percent.

Reductions to marketing and outreach for the federally facilitated marketplace began in the final week of open enrollment 2017 and continued into the 2018 open enrollment period. Total enrollment in the federally facilitated marketplace in 2018 closed with 8.7 million, down 9 percent from the 2016 level. To the extent a risk pool is shrinking, it is very likely to be getting “less healthy” and more expensive for all those insured, especially for the 6 million unsubsidized individuals who do not receive the Advanced Premium Tax Credit to offset the premium increases.

While not specific to California, a new analysis estimates statewide average premium increases in 2019, absent federal policies to stabilize these markets, could range from 16 to 30 percent — with some carriers in certain states having even higher rate increases, depending on state factors.

Factors that affect state-specific circumstances include whether the state is supported by the FFM (and its decisions on marketing) or by a state-based marketplace (SBM) making independent investments in marketing, the state insurance-regulatory environment and what that means for potential products or policies that siphon risk out of the individual market, and other market factors. The 2019 premium impact of several policies are estimated and discussed below and summarized in Table: 2019 Premium Driver Estimates and Mitigation Options.

Table 2019 Premium Driver Estimates and Mitigation Options

PREMIUM-INCREASE DRIVERS

Estimates reflect potential state average increases; some states and individual carriers could be higher or lower. Premium estimates reflect gross premiums; for those receiving subsidies, premium increases would likely be far less.

	Low	Medium	High
Premium Drivers on Top of Medical Trend	8.6%	14.7%	23.2%
Individual Mandate Premium Impact	8%	10%	13%
2018 Enrollment Change Premium Impact	-2.3%	1.3%	6.3%
2019 Ongoing Marketing Reduction Premium Impact	2.6%*	2.6%	2.6%
Short-Term and Association Health Plans	0.3%	0.8%	1.3%
Medical Trend	7.0%	7.0%	7.0%
Total Potential 2019 State-Level Premium Rate Increase	15.6%	21.7%	30.2%

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- **Elimination of the Individual Mandate Penalty:** The Tax Cuts and Jobs Act eliminated the individual mandate penalty, effective January 2019. In November 2017, the Congressional Budget Office estimated that elimination of the individual mandate could drive a rate increase of 10 percent on average. The impact within each state will vary based on a variety of factors, including the health of the state's risk pool, carrier competition and the strength of marketing and outreach efforts. States may expect a low impact of 8 percent and a high impact of 13 percent depending on state-specific factors.
- **Premium increases caused by enrollment reductions and deteriorating risk pool (Marketing and Other Factors) in Federally Facilitated Marketplace States:** Even in the face of net premium reductions for the majority of consumers who receive premium subsidies, the FFM states in the 2018 plan year had 5 percent fewer new sign-ups compared to 2017 and a reduction of 9 percent compared to FFM enrollment in 2016. The individuals who did sign up were likely less healthy on average than new enrollees in 2017. Some of the decline in enrollment is attributable to the federal decisions to reduce marketing — both at the end of the open enrollment period for plan year 2017 and for the recently completed enrollment period. Using an assumption that the individuals who — for whatever reason — were not persuaded to sign up are on average 25 percent less costly than the average enrollee, the analysis estimates that premiums in FFM states will increase by about 1.3 percent in 2019 due to the decreased marketing for the 2018 plan year. States with relatively unhealthy risk pools and lower 2018 enrollment compared to 2017 could see as much as a 6.3 percent rate increase in 2019 attributable to the marketing reduction and other factors that resulted in decreases in net enrollment for plan year 2018. On the other hand, states with higher enrollment in 2018 — including some SBM states — may see a slight downward pressure of up to 2.3 percent of their 2019 rates.
- **Impact of FFM and SBM Open Enrollment 2019 Marketing Decisions:** A continued policy of not using collected health plan user fees to promote enrollment for the 2019 plan year will likely result in lower enrollment, a worse risk mix and carriers that will price for this expectation with further increased premiums. While issuers' load for lack of marketing will vary, the analysis used an estimate of 2.6 percent, which builds on prior work on the impact of marketing on enrollment and risk mix. According to research commissioned by Covered California, some of the impacts to reduced marketing and outreach investments for 2018 may have been offset by substantial increases in media coverage generated by proposals to repeal and replace the Affordable Care Act and administration decisions regarding open enrollment 2018. During Oct. 1, 2017, through Dec. 15, 2017, the topics of "enrollment" and "enrollment period" and "deadline" were more frequently mentioned in news articles, increasing by 53 percent, 125 percent and 129 percent, respectively, when compared to the same period last year. Past research by Covered California has documented that both news coverage and paid advertising prompt action by consumers. This increased coverage of the shorter deadline and enrollment opportunities may have partially offset the absence of national or broadcast TV advertising for healthcare.gov, but it is unlikely to continue in 2019.
- **Association Health Plans and Short-Term, Limited-Duration Plans:** Assuming that federal regulations are finalized in time for the 2019 plan year, we estimate that Association Health Plans (AHPs) and short-term plans will result in a modest premium increase for 2019. Assuming that the individuals who leave will be

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25 percent less costly than the average enrollees in the common risk pool, the analysis estimates that AHPs and short-term plans together will increase rates between 0.3 and 1.3 percent in Affordable Care Act-compliant plans.

- **Medical Trend:** The analysis assumes an increase in medical costs of 7 percent based on current national averages. While actual impacts at the issuer level could vary significantly depending on state factors and policy decisions made in 2018, it's estimated that the addition of the factors listed above to the expected cost of medical inflation could produce 2019 average statewide premium increases between 15.6 and 30.2 percent. In addition, multiple states would be at risk for having the remaining carriers exit as well as a continued increase in both the number of states or parts of states with only one issuer and the number of individuals with only one issuer from which to choose. Given the fact that areas served by only one carrier generally face higher premiums, it is likely that in many parts of the nation these estimates understate the impacts that will be felt by consumers.

In summary, going into 2017, the individual insurance markets were largely stabilizing in terms of enrollment and issuer profitability. Yet the 2018 rate increases were significantly above medical cost, and the prospects of another year of such increases raises the stakes for policies that foster a strong individual market. Year-to-year policy actions or market uncertainty leads to both wide variation in premium impacts and carrier decisions that the market is not worth the risk. Both of these choices have negative consequences for enrollees, particularly those who do not qualify for premium subsidies.

Covered California for Small Business Forecast

The enrollment outlook of Covered California for Small Business (CCSB) builds on the operational improvements (e.g., group onboarding at, or better than, industry standard; timely commission payments; quickly resolving account maintenance issues), and better support from our agents and brokers. The CCSB program anticipates that enrollment will continue to grow in 2018. The sales and operations teams are continuing to improve and maintain better relationships with brokers. The focus continues to be on expanding activities such as implementation of agency-level agreements and strategic technology implementations. They continue to focus on group retention by improving communication outreach.

Because of these anticipated improvements and the trends seen over the past year, overall CCSB enrollment is expected to rise modestly through FY 2020-21. Similar to the individual market enrollment projections, a Base Estimate enrollment forecast was developed. The updated forecast is built on the experience of the past three years and takes into account the overall size and expected growth of the small business exchange market in California. CCSB currently represents about 8 percent of the exchange market. The base forecast assumes that expected program improvements will grow CCSB market share to 9 percent in 2019. Thereafter, CCSB enrollment growth will keep pace with the anticipated growth of the small business exchange market.

Beginning in 2017, the Covered California assessment rate was based on a percentage of gross health plan premium at 5.2 percent. For plan year 2018, this rate will be continued at 5.2 percent.

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Covered California's Multi-Year Forecast and Reserves

Covered California began its current fiscal year with a healthy operating reserve. Consistent with its guiding financial principles, the reserve amount is based on maintaining a level that is sufficient to assure an adequate balance to address uncertainties and to allow for timing lags needed to adjust revenue and expenditures. Adjustments in the plan assessment, for example, take nine to 18 months to have an impact on plan-assessment revenue. For these reasons, it is necessary to develop projections within the framework of a multi-year plan.

The FY 2017-18 multi-year forecast is displayed below. Revenues, which include both the individual and CCSB markets, are calculated on a cash basis that reflects the actual timing of the collection of revenue.

<i>Dollars in Millions</i>					
	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20	FY 2020-21
Effectuated Enrollment (fiscal year end)	1,371,949	1,321,919	1,305,646	1,311,360	1,333,280
Opening Balance	\$325.1	\$292.0	\$286.8	\$295.6	\$306.6
Plan Assessments-Cash Basis	\$242.1	\$314.4	\$325.8	\$331.0	\$331.9
Expenditures Projected ¹	(\$275.2)	(\$319.6)	(\$317.0)	(\$320.0)	(\$323.0)
Year-End Operating Reserve	\$292.0	\$286.8	\$295.6	\$306.6	\$315.5
<i>Number of months of reserve</i>	11.0	10.9	11.1	11.4	11.6

Plan Year	2018	2019	2020	2021
Plan Assessment Rate	4.00%	3.75%	3.50%	3.25%
Plan Assessment Rate On/Off Exchange	2.49%	2.33%	2.17%	2.03%
Premium Growth Assumptions	9.00%	7.00%	7.00%	7.00%

The plan assessment is at a level of 4 percent of premium for 2018, at 3.75 percent in 2019, 3.5 percent in 2020 and 3.25 percent in 2021. CCSB plan assessments are at a level of 5.2 percent of premium for the duration of the forecast. The forecast includes revenue from family dental coverage, which is assessed at the same rates as the medical coverage offered on the individual and CCSB markets. To the extent enrollment varies from the Base Estimate forecast, Covered California would be able to adjust its revenue by increasing or decreasing the plan assessment, or by adjusting its budgeted expenditures. It is important to note that each year a new multi-year forecast will be completed based on the most current information, so the estimates presented here could change.

Targeted Reserve Position

Numerous analyses have been conducted to identify the appropriate level of reserves necessary to provide sufficient time to make fiscal adjustments in the event of a decline in enrollment. Specifically, an analysis performed at the end of 2016 indicated that given the ability to reduce both contractual and personnel expenditures (the latter primarily through attrition), Covered California's existing reserve position at the time of nine to 10 months was adequate to cover a significant reduction in enrollment.

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The analysis also indicated that should Covered California's reserve position fall below the nine-to-10-month level, there is some risk that reserves, in conjunction with reductions to expenditures, may not be adequate to maintain solvency in the event of possible enrollment reductions. Because of this, the analysis concluded that Covered California should implement a reserve strategy that maintains reserves at a slightly higher level of nine to 12 months in the near term.

Given the uncertainties facing Covered California's enrollment outlook stemming from the potential for federal legislative action to change key provisions of the Affordable Care Act, it is prudent to maintain reserves at the high end of this range.

Covered California reports can be found here:

Individual Markets Nationally Face High Premium Increases in Coming Years <http://hbex.coveredca.com/data-research/>

The Roller Coaster Continuous <http://hbex.coveredca.com/data-research/>

Fiscal Year 2017-18 Budget <http://hbex.coveredca.com/financialreports/>

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Statement of Net Position

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Assets and Deferred Outflows	2017
Current assets:	
Cash and cash equivalents	\$ 357,954,323
Receivables:	
Enrollment fees (net of allowance for cancelled enrollments)	32,863,380
Receivables from state agencies	213,086
Other receivables	872,762
Total receivables	<u>33,949,228</u>
Other current assets	1,089,437
Total current assets	<u>392,992,988</u>
Noncurrent assets:	
Capital assets, net	<u>201,261,120</u>
Total assets	<u>594,254,108</u>
Deferred Outflows of Resources	<u>34,903,415</u>
Total assets and deferred outflows of resources	<u>629,157,523</u>
 Liabilities and Deferred Inflows	
Current liabilities:	
Accounts payable	39,165,581
Accrued liabilities	443,331
Deferred revenue	6,226,447
Compensated absences	4,215,601
Total current liabilities	<u>50,050,960</u>
Noncurrent liabilities:	
Compensated absences	2,634,191
Other liabilities	470,783
Other postemployment benefits	29,491,918
Net pension liability	165,589,315
Total noncurrent liabilities	<u>198,186,207</u>
Total liabilities	<u>248,237,167</u>
Deferred Inflows of Resources	<u>380,221</u>
Total liabilities and deferred inflows of resources	248,617,388
Net Position	
Net investment in capital assets	201,261,120
Unrestricted	179,279,015
Total net position	<u>\$ 380,540,135</u>

See accompanying notes to financial statements.

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

Statement of Revenues, Expenses, and Changes in Net Position
Year ended June 30, 2017

	2017
Operating revenues:	
Enrollment fees-individual	\$ 255,984,302
Enrollment fees-CCSB	7,256,893
Total operating revenues	263,241,195
 Operating expenses:	
Salaries, wages, benefits	\$ 126,931,102
Operating expenses and equipment	11,141,597
Professional services	131,570,145
Enrollment assistance fees	10,951,136
Facilities operations	4,612,531
Communications	279,448
Depreciation expense	40,813,697
Total operating expenses	326,299,656
Operating loss	(63,058,461)
 Nonoperating revenues:	
Interest income	\$ 2,626,112
Other income	30,542
Total nonoperating revenues	2,656,654
Change in net position	(60,401,807)
Total net position – beginning of year	440,941,942
Total net position – end of year	\$ 380,540,135

See accompanying notes to financial statements.

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

Statement of Cash Flows

Year ended June 30, 2017

	2017
Cash flows from operating activities:	
Receipts from enrollment fees	\$ 244,247,393
Payments to employees and for employee benefits	(91,326,087)
Payments to suppliers	(160,911,098)
Net cash used in operating activities	(7,989,792)
Cash flows from noncapital financing activities:	
Operating grants	5,780,143
State - reimbursements	3,968,265
Net cash provided by noncapital financing activities	9,748,408
Cash flows from capital and related financing activities:	
Capital grants	15,230,713
Acquisition of capital assets	(13,190,340)
Net cash provided by capital and related financing activities	2,040,373
Cash flows from investing activities:	
Interest income	2,280,108
Net increase in cash and cash equivalents	6,079,097
Cash and cash equivalents – beginning of year	351,875,226
Cash and cash equivalents – end of year	\$ 357,954,323
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	(63,058,461)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation	40,813,697
Changes in assets and liabilities:	
Increase in accounts receivable	(18,993,804)
Increase in other assets	(421,123)
Increase in pension obligations	(20,888,358)
Decrease in accounts payable	(1,935,117)
Increase in accrued liabilities	42,736,904
Increase in compensated absences	682,601
Increase in other postemployment benefits	12,603,086
Increase in other liabilities	470,783
Net cash used in operating activities	\$ (7,989,792)
Supplemental disclosure of non-cash activities:	
Capital asset purchases included in accounts payable	\$ 2,066,991

See accompanying notes to financial statements.

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

Notes to Financial Statements

June 30, 2017

(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 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 Statement of Revenues, Expenses and Changes in Net Position. Operating revenues began in fiscal year 2013-14, and result from monthly enrollment fees assessed on health insurance companies for policies sold through the marketplace for the individual and Covered California for Small Business (CCSB) markets.

Effective January 2017, Covered California's assessment fee switched from a flat per-member-per-month fee to a percent assessment on total premiums paid.

From July 2016 to December 2016, in the individual market, Covered California charged the health insurance carriers a per-member-per-month fee for effectuated members of \$13.95 per medical enrollee and of \$0.83 per dental enrollee.

From January 2017 to June 2017, in the individual market, Covered California charged the health insurance carriers a 4 percent assessment fee on total premiums paid for both medical and dental enrollees.

From July 2016 to December 2016, in the CCSB market, Covered California charged the health insurance carriers a per-member-per-month fee for effectuated members of \$18.60 per medical enrollee and of \$0.83 per dental enrollee.

From January 2017 to June 2017, in the CCSB market, Covered California charged the insurance carriers a 5.2 percent fee on total premiums paid for both medical and dental enrollees.

**CALIFORNIA HEALTH BENEFIT EXCHANGE
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June 30, 2017

Covered California recognizes individual and CCSB 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 Federal 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.

(e) Receivables

Receivables represent amounts owed by the California DHCS for its share of the costs related to California Healthcare Eligibility, Enrollment, and Retention System (CalHEERS) of \$213,086 as of June 30, 2017. Receivables also include amounts due from health insurance carriers for enrollment fees and small businesses for premiums in the amount of \$32.9 million, and amounts due from employees of \$111,182, and amounts due from the Surplus Money Investment Fund (SMIF) of \$761,580.

(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 went live on October 1, 2013. Intangible assets are considered internally generated if they are created or produced by Covered California or an entity contracted by Covered California, or if they are acquired from a third party but require more than minimal incremental effort on the part of Covered California 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 2016 through June 30, 2017 were \$12.1 million. Depreciation of the intangible assets began on October 1, 2013, and totaled \$39.2 million for fiscal year 2016-17.

(g) Accounts Payable

Accounts payable represents amounts owed by Covered California to third parties.

(h) Compensated Absences Payable

Vacation balances are accrued as a liability.

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

Notes to Financial Statements

June 30, 2017

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

(j) Pensions

Covered California has adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. GASB Statement No. 68 revises existing standards for measuring and reporting pension liabilities. This statement 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 plan's fiduciary net position. The total pension liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits. This Statement requires that most changes in the net pension liability be included in pension expense in the period of the change.

For purpose of measuring the net pension liability, deferred outflows and inflows of resources related to pensions, and pension expense, information contained within Covered California has been determined on the same basis as they are reported by the California Public Employees' Retirement System (CalPERS) Financial Office and the State Controller's Office.

(k) Deferred Outflows of Resources and Deferred Inflows of Resources

Changes in net pension liability not included in pension expense are reported as deferred outflows of resources or deferred inflows of resources. Employer contributions subsequent to the measurement date of the net pension liability are reported as deferred outflows of resources. The unamortized net difference between projected and actual earnings on investments are recorded as deferred inflows of resources.

**CALIFORNIA HEALTH BENEFIT EXCHANGE
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June 30, 2017

(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.

	2017
State treasury	\$ 26,317,323
Surplus money investment fund (SMIF)	331,637,000
Total	\$ 357,954,323

As of June 30, 2017, the carrying value of deposits in the SMIF represents the fair value. The SMIF consists of the available cash of 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.

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.

At June 30, 2017, the allocation of the deposits held by Covered California in the SMIF was estimated as follows:

	Covered California's Share of SMIF
U.S. Treasury Securities	\$ 142,487,063
Federal Agency Debt	57,561,182
Supranational Debentures	1,709,711
Bank Notes	2,565,555
Certificates of Deposit	65,421,657
Commercial Paper	35,165,631
Time Deposits	23,965,450
AB 55 and General Fund Loans	2,760,751
Total	\$ 331,637,000

**CALIFORNIA HEALTH BENEFIT EXCHANGE
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The value of the deposits in the State Treasurer’s pooled investment program, including the SMIF, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2017, this difference was immaterial to the valuation of the deposits held by Covered California in the SMIF.

Covered California’s share in the interest earnings of the PMIA is based on its ratio of dollar-day contributions to the total dollar-day investments of the PMIA. The overall return on investment for the PMIA was 0.75 percent for the year ended June 30, 2017.

Additional disclosures regarding investment risks, interest rate risk, credit risk, custodial credit risk and concentration of credit risk, are presented in the financial statements of the State of California for the year ended June 30, 2017.

(3) Capital Assets

Changes in capital assets for the year ended June 30, 2017 are as follows:

	<u>Balance</u> <u>July 1, 2016</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2017</u>
Depreciable assets-development costs:				
Internally developed software	\$ 254,065,793	\$ 12,062,895	—	\$ 266,128,688
Hardware	23,246,720	20,213	—	23,266,933
Licenses and purchased software	41,957,912	55,584	—	42,013,496
Total depreciable assets development costs	<u>\$ 319,270,425</u>	<u>\$ 12,138,692</u>	<u>—</u>	<u>\$ 331,409,117</u>
Depreciable capital assets:				
Office furniture and equipment	5,997,967	975,970	—	6,973,937
Leasehold improvements	2,799,813	75,678	—	2,875,491
Total depreciable capital assets	<u>\$ 8,797,780</u>	<u>\$ 1,051,648</u>	<u>—</u>	<u>\$ 9,849,428</u>
Less accumulated depreciation:				
Asset development costs	(96,074,464)	(39,174,473)	—	(135,248,937)
Office furniture and equipment	(2,408,592)	(1,230,241)	—	(3,638,833)
Leasehold improvements	(700,672)	(408,983)	—	(1,109,655)
Total accumulated depreciation	<u>\$ (99,183,728)</u>	<u>\$ (40,813,697)</u>	<u>—</u>	<u>\$ (139,997,425)</u>
Total capital assets, net	<u>\$ 228,884,477</u>	<u>\$ (27,623,357)</u>	<u>—</u>	<u>\$ 201,261,120</u>

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

Notes to Financial Statements

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(4) Leases

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

The future minimum lease payments under current operating leases as of June 30, 2017 are as follows:

For the year ending June 30:	
2018	6,199,412
2019	6,192,356
2020	5,219,102
2021	3,608,591
Thereafter	2,902,717

Rental expense for operating leases totaled \$6.2 million for the year ended June 30, 2017.

(5) Retirement Planning and Other Postemployment Benefits

(a) Retirement Plan

Covered California adopted GASB 68 during the 2014-15 fiscal year. GASB 68 requires that the reported results pertain to liability and asset information within certain defined timeframes. For this report, the following timeframes are used:

Valuation date (VD)	June 30, 2015
Measurement date (MD)	June 30, 2016
Measurement period (MP)	July 1, 2015 to June 30, 2016

At the time provisions of GASB 68 were adopted, Covered California did not have the necessary pension information to determine the amounts of all deferred outflows and inflows of resources related to pensions, so it was not practical to restate the prior period financial statements.

Plan Description, Benefits Provided, and Employees Covered

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. Covered California has employees who are enrolled in the State Miscellaneous Plan (First Tier and Second Tier). 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.

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

**CALIFORNIA HEALTH BENEFIT EXCHANGE
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June 30, 2017

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.

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 ten years of service, depending on the plan selected by the employee. However, the Public Employees' Pension Reform Act, or PEPRRA, 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.

Contributions

Section 20814 (c) of the California Public Employees' Retirement Law (PERL) requires that the employer contribution rates for all public employers are determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. The total plan contributions are determined through the CalPERS' annual actuarial valuation process. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The employer is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. For the Miscellaneous Plan measurement period ended June 30, 2016, the active employee contribution rate is 8 percent to 10 percent of annual pay for Tier 1 and 3.75 percent of annual pay for Tier 2, and the employer's contribution rate is 26.728 percent of annual payroll for Tier 1 and 26.984 percent of annual payroll for Tier 2. These rates reflect PERL Section 20683.2, which mandates that certain employees contribute more as of July 1, 2013. Furthermore, any reduction in employer contributions due to the increase in the employee contributions must be paid by the employer towards the unfunded liability. It is the responsibility of the employer to make necessary accounting adjustments to reflect the impact due to any employer-paid member contributions or situations where members are paying a portion of the employer contribution.

Discount Rate

In preparation for implementing GASB 68, CalPERS prepared the GASB 68 Accounting Valuation Reports (AVRs) for the State of California for the eight plans (including the State Miscellaneous Plan) in which the State participates. CalPERS utilized a discount rate of 7.65 percent, which includes the plans' administrative expenses.

Pension Liabilities, Pension Expense, and Deferred Outflows and Deferred Inflows of Resources Related to Pensions

The State Controller's Office (SCO) used a calculated percentage based on Covered California's share of the pensionable compensation to the State's total pensionable compensation amounts for the State Miscellaneous Plan, to provide Covered California's net pension liability and related GASB 68

**CALIFORNIA HEALTH BENEFIT EXCHANGE
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accounting elements. Covered California's calculated percentage was 0.500055 percent for the State Miscellaneous Plan. Covered California's net pension liability for the State Miscellaneous Plan was \$121.0 million at the beginning of the measurement period (MP) and \$165.6 million at the end of the MP.

As of the start of the measurement period, July 1, 2015, the net pension liability was \$121,049,500.

For the measurement period, June 30, 2016 (the measurement date), Covered California Fund incurred a non-cash pension expense of \$38,572,362.

As of the measurement date of June 30, 2016, Covered California had deferred outflows and deferred inflows of resources related to pensions as follows:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension Contributions Subsequent to Measurement Date	\$ 14,920,905	\$ -
Difference Between Expected and Actual Experiences	1,689,851	(380,221)
Net Difference In Projected and Actual Earnings on Pension Plan Investment	18,292,659	-
Total	\$ 34,903,415	\$ (380,221)

Exclusive of deferred outflows related to payments after the measurement date, the net amount of deferred outflows (inflows) of resources related to pensions that will be recognized in pension expense during the next five years and thereafter is as follows:

Measurement Period ended June 30:	Deferred Outflows/(Inflows) of Resources
2017	\$ 3,920,458
2018	\$ 3,920,458
2019	\$ 3,920,458
2020	\$ 3,920,458
2021	\$ 3,920,458
Thereafter	\$ -
Total	\$ 19,602,289

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Actuarial Methods and Assumptions Used to Determine Total Pension Liability

The total pension liability was based on an actuarial valuation as of June 30, 2015, rolled forward to June 30, 2016, based on the following actuarial methods and assumptions:

Actuarial Cost Method:	Entry Age Normal in accordance with the requirements of GASB Statement No. 68
Amortization Method/Period:	Actuarial Policy ACT-96-05E specifies that all changes in liability due to plan amendments, changes in actuarial assumptions, or changes in actuarial methodology are amortized separately over a 20-year period. In addition, all gains or losses are tracked and the net unamortized gain or loss is amortized as a rolling 30-year amortization with the exception of gains and losses in fiscal years 2008-09, 2009-10 and 2010-11 in which years' gains or losses will be isolated and amortized over fixed and declining 30-year periods (as opposed to the current rolling 30-year amortization). Also, if a plan's accrued liability exceeds the actuarial value of assets, the annual contribution with respect to the total unfunded liability may not be less than the amount produced by a 30-year amortization of the unfunded liability. Finally, all plans are subject to a minimum employer contribution rate equal to the employer normal cost plus a 30-year amortization or surplus, if any.
Asset Valuation Method:	Fair Value
Inflation:	2.75%
Salary Increases:	Varies by entry age and service
Payroll Growth:	3.00%
Investment Rate of Return:	7.65%
Retirement Age:	The probabilities of retirement are based on the 2014 CalPERS Experience Study for the period from 1997 to 2011.
Mortality Rate Table:	The probabilities of mortality are based on the 2014 CalPERS Experience Study for the period from 1997 to 2011. Pre-retirement and post-retirement mortality rates include 20 years of projected mortality improvement using Scale BB published by the Society of Actuaries.

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Post Retirement Benefit Increase: Contract cost of living adjustment up to 2.75% until purchasing power protection allowance floor on purchasing power applies, 2.75% thereafter.

The Mortality Rate Table used was developed based on CalPERS specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB. For more details on the Mortality Rate Table, please refer to the 2014 experience study report.

All other actuarial assumptions used in the June 30, 2015, valuation were based on the results of an actuarial experience study for the period from 1997 to 2011, including updates to salary increase, mortality and retirement rates. The Experience Study report can be obtained at the CalPERS website under Forms and Publications.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, CalPERS' staff took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Using historical returns of all the funds' asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

The table below reflects long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation used to measure the total pension liability. An expected inflation rate of 2.5 percent was used for real return years 1-10. For real return years 11+, an inflation rate of 3.0 percent was used.

Asset Class	Current Target Allocation	Real Return Years 1-10	Real Return Years 11+
Global equity	51.00%	5.25%	5.71%
Global fixed income	20.00%	0.99%	2.43%
Inflation sensitive	6.00%	0.45%	3.36%
Private equity	10.00%	6.83%	6.95%
Real Estate	10.00%	4.50%	5.13%
Infrastructure and forestland	2.00%	4.50%	5.09%
Liquidity	1.00%	(0.55%)	(1.05%)
Total	<u>100.00%</u>		

**CALIFORNIA HEALTH BENEFIT EXCHANGE
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In December 2016, the CalPERS Board of Administration voted to lower the discount rate used in its actuarial assumptions from 7.65 percent to 7.15 percent (including administrative expenses) effective July 1, 2017, over a three year period. As shown in the table below, a similar reduction to the discount rate in accordance with GASB 68 will increase the net pension liability. This increase will be amortized over the expected remaining service lives of all employees provided with benefits through the pension plans.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of Covered California as of June 30, 2016, calculated using the discount rate of 7.65 percent, as well as what the pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.65 percent) or 1 percentage-point higher (8.65 percent) than the current rate:

	Discount Rate -1%	Current Discount Rate	Discount Rate + 1%
	(6.65%)	(7.65%)	(8.65%)
Miscellaneous Plan	\$225,431,155	\$165,589,315	\$115,350,875

Pension Plan Fiduciary Net Position

Each plan’s fiduciary net position disclosed in the accounting valuation report provided by CalPERS may differ from the plan’s assets reported in the funding actuarial valuation report due to several reasons; the accounting valuation report must keep items such as deficiency reserves, fiduciary self-insurance, and OPEB expenses included as assets. These amounts are excluded for rate setting purposes in the funding actuarial valuation report.

(b) Other Postemployment Benefits

Postretirement healthcare benefits are also provided to Covered California retirees through the programs sponsored by the State as administered by CalPERS and the California Department of Human Resources (CalHR). As the postretirement healthcare plan is sponsored by the State, it is considered a single-employer plan. The total other postemployment benefits (OPEB) actuarial accrued liability is reported at the State level.

Healthcare and dental benefits may be provided to members depending on the date hired and the member’s years of credited service. 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 2016-17 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

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monthly contribution maximums are \$707 for a single enrollee, \$1,349 for an enrollee and one dependent, and \$1,727 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 prorated based on the years of service.

Covered California paid approximately \$4.7 million for postretirement health and dental benefits for retired members for the year ended June 30, 2017. Covered California has adopted GASB Statement No. 45. 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 benefit costs in relation to the total State retiree health benefit costs. The ARC represents normal cost plus an amortization of the difference between the actuarial accrued liability and any asset available to pay benefits. For the year ended June 30, 2017, Covered California's AOC was \$19.6 million and Covered California's total net OPEB obligation (NOO) was \$29.5 million. The following table shows the components of Covered California for the year ended June 30, 2017 and the previous four fiscal years.

Net OPEB obligation (NOO), July 1, 2013	\$	125,482
Allocated annual OPEB cost (AOC)		1,632,434
Fund allocated contributions		(578,440)
		1,179,476
Net OPEB obligation (NOO), July 1, 2014		1,179,476
Allocated annual OPEB cost (AOC)		7,991,912
Fund allocated contributions		(3,017,172)
		6,154,216
Net OPEB obligation (NOO), June 30, 2015		6,154,216
Allocated annual OPEB cost (AOC)		16,580,792
Fund allocated contributions		(5,846,176)
		16,888,832
Net OPEB obligation (NOO), June 30, 2016		16,888,832
Allocated annual OPEB cost (AOC)		19,585,470
Fund allocated contributions		(6,982,384)
		29,491,918
Net OPEB obligation (NOO), June 30, 2017	\$	29,491,918

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

(6) Commitments and Contingencies

As of June 30, 2017, Covered California has outstanding commitments of \$34.4 million related primarily to information technology projects.

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

Notes to Financial Statements

June 30, 2017

(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.

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

Required Supplementary Information

June 30, 2017

SCHEDULE OF COVERED CALIFORNIA'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY

	<u>2015</u>	<u>2016</u>	<u>2017</u>
Covered California's Proportion of the Net Pension Liability	0.224583%	0.428616%	0.500055%
Covered California's Proportionate Share of the Net Pension Liability	\$ 53,473,665	\$ 121,049,500	\$ 165,589,315
Covered California's Covered-Employee Payroll	\$ 22,502,642	\$ 45,608,536	\$ 55,957,084
Covered California's Proportionate Share of the Net Pension Liability as a Percentage of its Covered-Employee Payroll	237.63%	265.41%	295.92%
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	74.17%	70.68%	66.81%

(1) Amounts presented were determined as of June 30th of the prior fiscal year.

(2) Data is being accumulated annually to present 10 years of the reported information.

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

Required Supplementary Information

June 30, 2017

SCHEDULE OF PLAN CONTRIBUTIONS

	<u>2015</u>	<u>2016</u>	<u>2017</u>
Actuarially Determined Contribution	\$ 11,090,990	\$ 14,066,553	\$ 14,920,905
Contribution in Relation to the Actuarially Determined Contribution	<u>(11,090,990)</u>	<u>(14,066,553)</u>	<u>(14,920,905)</u>
Contribution Deficiency (Excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Covered-Employee Payroll	\$ 22,506,125	\$ 45,608,536	\$ 55,957,084
Contributions as a Percentage of Covered-Employee Payroll	49.28%	30.84%	26.66%

(1) Data is being accumulated annually to present 10 years of the reported information.



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*

To the Board of Directors
California Health Benefit Exchange
Sacramento, California

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) as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise Covered California's basic financial statements, and have issued our report thereon dated April 25, 2018.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies 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 identify the following deficiencies in internal control that we consider to be significant deficiencies:

Financial Close & Reporting

As a result of our audit procedures, it was discovered that adjustments were required to be made to the Other Liabilities and Accounts Receivable to State Agencies accounts having a net income statement effect of roughly \$374,000. These adjustments were necessary as part of the Budgetary-Legal to GAAP conversion process. Upon further analysis, it was discovered that GAAP adjustments made in the previous year had self-corrected in the budgetary legal system and needed to be reversed on the conversion worksheet to establish the proper beginning balances. We recommend that the agency review all prior year GAAP adjustments as part of their closing process to determine the items that have been reflected in the budgetary legal system and need to be reversed.





CPAs AND ADVISORS

To the Board of Directors
California Health Benefit Exchange
Sacramento, California

Covered California's Response:

Covered California continues to implement corrective actions to better identify needed entries to convert the Budgetary/Legal modified accrual basis financial statements to GAAP full accrual financial statements. Covered California has obtained additional accounting staff that are solely dedicated to assisting in preparation of the GAAP financial statements.

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 Findings

Covered California's response to the findings identified in our audit was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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 the Covered California's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Lance, Solt & Lughard, LLP

Brea, California
April 25, 2018