



Pre-Existing Condition Insurance Plan

An Enterprise Fund of the State of Utah

Financial Report

For the Year Ended December 31, 2012

Federal-HIPUtah

Pre-Existing Condition Insurance Plan

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OFFICE OF THE
UTAH STATE AUDITOR

INDEPENDENT STATE AUDITOR'S REPORT

To the Board of Directors, Audit Committee
and
Tomi Ossana, Executive Director
Utah Comprehensive Health Insurance Pool

Report on the Financial Statements

We have audited the accompanying financial statements of Federal-HIPUtah, a Pre-Existing Condition Insurance Plan, which is an enterprise fund of the State of Utah, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise Federal-HIPUtah's 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 an opinion 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 financial statement 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 financial position of Federal-HIPUtah as of December 31, 2012, and the changes in financial position and

cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Discontinuation of Operations

As disclosed in Note 1, the Federal-HIPUtah program will only offer coverage until December 31, 2013, at which time the program will enter the contract close-out period. The close-out period will run from January 1, 2014 through June 30, 2015, during which time there will be a claims run-out period where claims incurred through December 31, 2013 will be paid.

Reporting Entity

As disclosed in Note 1, the financial statements of Federal-HIPUtah are intended to present the financial position, and the changes in financial position and, where applicable, cash flows of only that portion of the State of Utah that is attributable to the transactions of Federal-HIPUtah. They do not purport to, and do not, present fairly the financial position of the State of Utah, as of December 31, 2012, the changes in its financial position or, where applicable, cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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 29, 2013 on our consideration of Federal-HIPUtah'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 Federal-HIPUtah's internal control over financial reporting and compliance.

Office of the Utah State Auditor

April 29, 2013

Federal-HIPUtah

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Management's Discussion and Analysis For the Year Ended December 31, 2012

The following is a discussion and analysis of Federal-HIPUtah's financial performance for the year ended December 31, 2012. It is intended to serve as an introduction to Federal-HIPUtah's financial statements.

Highlights

Total operating expenses for the year exceeded operating revenues resulting in a \$34,041,057 operating loss for Federal-HIPUtah's calendar year 2012. The \$34,041,057 operating loss was covered by non-operating federal revenues so net position remained zero as of December 31, 2012. Federal-HIPUtah had 1,267 active enrollees as of December 31, 2012. Enrollment is expected to decrease at a rate of 5 percent per month starting in March of 2013 due to an enrollment suspension.

Overview of the Financial Statements

Federal-HIPUtah's financial statements are comprised of four components: 1) the Statement of Net Position, 2) the Statement of Revenues, Expenses, and Changes in Net Position, 3) the Statement of Cash Flows, and 4) the Notes to the Financial Statements.

The Statement of Net Position provides information on Federal-HIPUtah's assets and liabilities as of the end of the calendar year, with the difference reported as net position. The information provided in the Statement of Net Position along with the information contained in the Statement of Revenues, Expenses, and Changes in Net Position, the Statement of Cash Flows, and the Notes to the Financial Statements can help assess Federal-HIPUtah's liquidity and its ability to meet its obligations.

The Statement of Revenues, Expenses, and Changes in Net Position provide information about operating results and non-operating transactions and their effect on the net position of Federal-HIPUtah. The information in this statement, together with the information in the Statement of Net Position, the Statement of Cash Flows, and the accompanying notes can assist in evaluating Federal-HIPUtah's performance during the period.

The Statement of Cash Flows presents information about the cash receipts and cash payments of Federal-HIPUtah during the period. When used with the related information in the other financial statements, a statement of cash flows can help assess Federal-HIPUtah's ability to meet its obligations as they come due and the reasons for the differences between operating losses and the associated cash receipts and payments.

The Notes to the Financial Statements include additional information that is essential to a complete understanding of the data provided in the financial statements.

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Financial Analysis

The schedule below summarizes Federal-HIPUtah's financial statements for the years ended December 31, 2011 and December 31, 2012. The changes in assets, liabilities, revenues, and expenses are also presented for these two years.

Changes in Assets, Liabilities, and Net Position For the Years Ended December 31, 2011 and December 31, 2012				
	2011	2012	Change Amount	Percent Change
Cash	\$ -	\$ 377,854	\$ 377,854	100%
Premium and Other Receivables	32,571	170,545	137,974	424%
Federal Contract Receivable	2,946,976	5,719,395	2,772,419	94%
Prepaid Expense	10,083	10,184	101	1%
Total Assets	2,989,630	6,277,978	3,288,348	110%
Accounts Payable	41,235	42,726	1,491	4%
Unearned Premiums	43,429	100,622	57,193	132%
Interfund Payable	57,393	-	(57,393)	-100%
Benefit Claims Liability	2,847,573	6,134,630	3,287,057	115%
Total Liabilities	2,989,630	6,277,978	3,288,348	110%
Net Position	\$ -	\$ -	\$ -	0%
Operating Revenue - Premiums	\$ 1,748,217	\$ 4,698,804	\$ 2,950,587	169%
Operating Expenses:				
Program Administrator Fees	161,720	335,827	174,107	108%
Medical and Pharmacy Benefit Claims	11,747,084	34,901,050	23,153,966	197%
Change in Actuarial Estimate of Benefit Claims Liability	1,950,243	3,287,057	1,336,814	69%
Other Professional and Technical Services	194,757	215,927	21,170	11%
Total Operating Expenses	14,053,804	38,739,861	24,686,057	176%
Operating Loss	(12,305,587)	(34,041,057)	(21,735,470)	177%
Non-Operating Revenue - Federal Contract	12,305,587	34,041,057	21,735,470	177%
Change in Net Position	\$ -	\$ -	\$ -	0%

The federal contract receivable of \$5,719,395 represents revenue earned for allowable administrative and estimated benefits claims costs incurred as of December 31, 2012, but not paid

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Management's Discussion and Analysis For the Year Ended December 31, 2012

by Federal-HIPUtah until after this date. A federal contract receivable at year end is expected since Federal-HIPUtah only draws federal funding on a reimbursement basis and when more cash is needed to pay expenses than has been received from premiums. The federal contract receivable increased \$2,772,419 or 94 percent from the prior year. The benefit claims liability of \$6,134,630 is an actuarial estimate of the ultimate cost of benefit claims that have been incurred but not reported as of December 31, 2012. The benefit claims liability increased \$3,287,057 or 115 percent from the prior year.

The total operating loss from the result of Federal-HIPUtah's second full year of operations between January 1 and December 31, 2012, was \$34,041,057. This is an increase of \$21,735,470 or 177 percent from the prior year. Total operating expenses for the year were \$38,739,861 and included \$34,901,050 in paid medical and pharmacy benefit claims and an additional actuarially estimated \$3,287,057 for the ultimate cost of benefit claims that were incurred, but not paid as of December 31, 2012. Total operating expenses increased \$24,686,057 or 176 percent from the prior year. Medical and pharmacy benefit claims increased \$23,153,966 or 197 percent from the prior year and the additional actuarially estimated ultimate cost of benefit claims that were incurred but not paid as of year end increased \$1,336,814 or 69 percent from the prior year.

The large increases in the items in the above two paragraphs are primarily due to increased enrollment and benefit utilization from the prior year. Federal-HIPUtah had 1,267 active enrollees as of December 31, 2012. This is an increase of 618 enrollees from the prior year. Enrollees that accessed coverage through this program did not have health insurance for at least the last six months before their effective date. These enrollees had major health conditions that were not treated and therefore had a pent up demand for high-cost medical services for the first several months on the program. The cost of providing these medical services and treatments exceeded the premiums charged. This is the main reason for the large operational loss. Benefit claims expenses for enrollees eligible for this program exceeded the federally regulated premiums charged. The Department of Health and Human Services (HHS) has agreed in their contract with the State of Utah to pay for claims for covered services plus allowable administrative costs incurred for administering the Federal-HIPUtah program that are in excess of the federally regulated premiums that are collected. As a result, the \$34,041,057 operating loss was covered by non-operating federal revenues so Federal-HIPUtah's net position remained at zero as of December 31, 2012.

Financial Outlook

Effective January 1, 2013 enrollment in the \$500 and \$1,000 deductible plans was capped to protect Federal-HIPUtah resources. While existing enrollees were allowed to maintain their plans, the projected savings for this action is approximately \$5 million and will reflect a slight decrease in average enrollment from prior estimates over the duration of this program.

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Management's Discussion and Analysis For the Year Ended December 31, 2012

In a continued effort to protect resources on a national level, the Center for Consumer Information and Insurance Oversight (CCIIO) on February 15, 2013, announced a decision to suspend new enrollment in the Pre-existing Condition Insurance Plan (PCIP). Federal-HIPUtah implemented this suspension effective March 2, 2013. Due to this suspension, Federal-HIPUtah's medical costs, drug costs, and enrollment are expected to decrease during the calendar year 2013. Enrollment in 2013 is expected to decrease at a rate of 5 percent per month starting in March of 2013. This is based on historical trends indicating that enrollees who have been enrolled for more than three months have a persistency rate of 95 percent per month. It is estimated that the operating loss for the program at the end of the 2013 year will be approximately \$27 million compared to 2012 operating loss of 34 million, a decrease of approximately 21 percent from 2012.

Federal-HIPUtah premiums will increase 6.5 percent effective July 1, 2013. Federal-HIPUtah, however, will continue to have operating expenses greater than premium revenue. The eligibility requirements for the program ensure that enrollees will continue to have medical conditions with associated costs that are likely to exceed the premiums charged. Variations in benefit claim costs from month-to-month and from year-to-year are also expected to occur given the combination of high risk/high cost enrollees. However, this variation is expected to decrease along with the higher disenrollment rates observed in prior years for new enrollees.

Federal-HIPUtah is only a temporary high-risk health insurance pool program under Section 1101 of the Patient Protection and Affordable Care Act. As such this insurance program will offer transitional coverage until December 31, 2013, when health insurance exchanges become available and pre-existing condition exclusions are prohibited.

Contacting Federal-HIPUtah's Management

This financial report is designed to provide the citizens of Utah and the United States with a general overview of Federal-HIPUtah's finances and to demonstrate Federal-HIPUtah's financial accountability over its resources.

If you have questions about this report or need additional information, contact Tomi Ossana, HIPUtah Executive Director, by email at tjossana@xmission.com.

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Pre-Existing Condition Insurance Plan

Statement of Net Position As of December 31, 2012	
Assets	
Current Assets:	
Cash	\$ 377,854
Premium and Other Receivables	170,545
Federal Contract Receivable	5,719,395
Prepaid Expense	10,184
Total Assets	6,277,978
Liabilities	
Current Liabilities:	
Accounts Payable	42,726
Unearned Premiums	100,622
Benefit Claims Liability	6,134,630
Total Liabilities	6,277,978
Net Position	\$ -

The accompanying notes are an integral part of the financial statements.

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Pre-Existing Condition Insurance Plan

Statement of Revenues, Expenses, and Changes in Net Position For the Year Ended December 31, 2012	
Operating Revenues:	
Premiums	\$ 4,698,804
Total Operating Revenue	4,698,804
Operating Expenses:	
Program Administrator Fees	335,827
Medical and Pharmacy Benefit Claims	34,901,050
Change in Actuarial Estimate of Benefit Claims Liability	3,287,057
Other Professional and Technical Services	215,927
Total Operating Expenses	38,739,861
Operating Loss	(34,041,057)
Non-Operating Revenues	
Federal Contract	34,041,057
Total Non-Operating Revenue	34,041,057
Change in Net Position	-
Net Position - Beginning	-
Net Position - Ending	\$ -

The accompanying notes are an integral part of the financial statements.

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Statement of Cash Flows For the Year Ended December 31, 2012	
Cash Flows from Operating Activities:	
Receipts from Premiums	\$ 4,616,268
Payments for Medical and Pharmacy Benefit Claims	(34,902,667)
Payments for Program Administrator Fees	(324,723)
Payments for Other Professional and Technical Services	(222,269)
Net Cash Used by Operating Activities	(30,833,391)
Cash Flows from Non-Capital Financing Activities:	
Repayment of Interfund Borrowing	(57,393)
Receipts from Federal Contract	31,268,638
Net Cash Provided by Non-Capital Financing Activities	31,211,245
Net Increase in Cash	377,854
Beginning Cash	-
Ending Cash	\$ 377,854
Reconciliation of Total Operating Loss to Net Cash Used by Operating Activities:	
Operating Loss	\$ (34,041,057)
Adjustments to Reconcile Total Operating Loss to Net Cash Used by Operating Activities:	
Net Changes in Assets and Liabilities:	
Premium and Other Receivables	(137,974)
Prepaid Expense	(101)
Unearned Premiums	57,193
Accounts Payable	1,491
Benefit Claims Liability	3,287,057
Net Cash Used by Operating Activities	\$ (30,833,391)

The accompanying notes are an integral part of the financial statements.

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Notes to the Financial Statements For the Year Ended December 31, 2012

1. Organization and Nature of Business

The Federal-HIPUtah program was established on September 1, 2010, by a contract between the U.S. Department of Health and Human Services (HHS) and the State of Utah Insurance Department. Federal-HIPUtah is a pre-existing condition insurance plan (PCIP) as enacted by Section 1101(b) of the Patient Protection and Affordable Care Act, Public Law 111-148, (the Affordable Care Act). This program provides health insurance coverage to uninsured residents of the State of Utah with pre-existing conditions who have been without insurance for at least six months. The program assumes the risk for health benefit claims made by these individuals and manages this risk by placing ceilings on enrollment when necessary, placing limitations on yearly and lifetime benefits, and through various other claim management methods. Federal-HIPUtah is federally subsidized. Enrollees pay federally regulated premium amounts and the balance of the costs of providing services is covered by contract funding from HHS.

The Federal-HIPUtah program will only offer coverage until December 31, 2013, when health benefit exchanges become available and pre-existing condition exclusions are prohibited as provided in the Affordable Care Act. Federal-HIPUtah enrollees will then be transitioned into qualified health plans offered through these health benefit exchanges.

HIPUtah administers the Federal-HIPUtah program for the State of Utah Insurance Department. HIPUtah is a nonprofit quasi-governmental entity within the State of Utah Insurance Department that provides access to health insurance coverage to Utah residents who are considered uninsurable. HIPUtah runs Federal-HIPUtah as a separate program. HIPUtah is governed by the HIPUtah Board. The HIPUtah Board is appointed by the Governor with the advice and consent of the Utah State Senate. The HIPUtah Board selects the HIPUtah Executive Director who has general oversight responsibilities for both the HIPUtah and the Federal-HIPUtah programs. The Plan Administrator is selected by the HIPUtah Board in accordance with the Utah Procurement Code. SelectHealth, a nonprofit health insurance company, is the Plan Administrator for both the HIPUtah and the Federal-HIPUtah programs.

These financial statements will be included in the State of Utah's Comprehensive Annual Financial Report for the fiscal year ending June 30, 2013, as an enterprise fund. Federal-HIPUtah is an enterprise fund of the State of Utah because it engages only in business-type activities and serves only customers outside of the state government organization.

2. Summary of Significant Accounting Policies

Basis of Accounting

The accounting and reporting policies of Federal-HIPUtah conform to accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB) and use the economic resources measurement focus and

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the full accrual basis of accounting. Under this basis of accounting, revenues are recognized when earned, and expenses are recognized when incurred. All assets and liabilities associated with Federal-HIPUtah are included on the Statement of Net Position.

Cash

For purposes of reporting cash flows, cash includes 1) deposits in the State of Utah's general operating cash pool, 2) cash received for premiums by SelectHealth by December 31, 2012, but not yet deposited in Federal-HIPUtah's bank account, 3) cash from benefit claim payments reversed or refunded back to SelectHealth as of December 31, 2012, but not yet refunded back to Federal-HIPUtah, and 4) cash paid for pharmacy claims by SelectHealth that has not been reimbursed by Federal-HIPUtah as of December 31, 2012. See Note 3 for additional information.

Accounts Receivable

The clients of Federal-HIPUtah remit premium payments directly to the Plan Administrator, SelectHealth. These premiums are transferred to the Federal-HIPUtah fund at the State of Utah Insurance Department at least every three days. The premium and other receivables balance on the Statement of Net Position includes premiums earned as of December 31, 2012, but not received by SelectHealth by this date. There is no allowance for doubtful accounts.

The federal contract receivable balance on the Statement of Net Position is for revenue earned according to the contract with HHS for allowable administrative and estimated benefit claims costs (see Benefit Claims Liability on next page) incurred as of December 31, 2012, but not paid by Federal-HIPUtah until after this date. No federal contract funding was drawn for these expenses because they were not paid for by Federal-HIPUtah as of December 31, 2012. Federal contract funding will be drawn to cover the cash required when these expenses are paid.

Prepaid Expense

The prepaid expense balance on the Statement of Net Position includes salary expenses not incurred by Federal-HIPUtah as of December 31, 2012, but paid prior to that date.

Accounts Payable

The accounts payable balance on the Statement of Net Position includes expenses incurred by Federal-HIPUtah as of December 31, 2012, but not paid until after that date. See Note 4 for additional information.

Unearned Premiums

The unearned premiums balance on the Statement of Net Position includes premiums received by SelectHealth by December 31, 2012 that were for periods after that date.

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Notes to the Financial Statements For the Year Ended December 31, 2012

Benefit Claims Liability

The liability for benefit claims includes an actuarial estimate of the ultimate cost of benefit claims that have been incurred but not reported. Because actual benefit claim costs depend on such complex factors as inflation and changes in insurance benefits, the process used in computing benefit claim liabilities does not necessarily result in an exact amount. Because of this, the benefit claims liability is recomputed periodically by an actuary to produce current estimates that reflect recent settlements, benefit claims frequency, and other economic and social factors. A provision for inflation is implicit in the calculation of estimated future benefit claims costs, because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience. Adjustments to the benefit claims liability for changes in estimates is charged or credited to benefit claims expense in the period in which it is made. See Note 5 for additional information.

Operating Revenues and Expenses

Operating revenues and expenses generally result from providing services in connection with Federal-HIPUtah's principal ongoing operations. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

3. Deposits

Federal-HIPUtah follows the requirements of the State of Utah Money Management Act (*Utah Code*, Section 51-7) in handling its depository transactions. Custodial credit risk is the risk that in the event of a bank failure, Federal-HIPUtah's deposits may not be recovered. Federal-HIPUtah's policy for managing its exposure to this risk is to comply with the Utah Money Management Act. This Act requires the deposit of Federal-HIPUtah funds in a qualified depository. The Act defines a qualified depository as any financial institution whose deposits are insured by an agency of the Federal Government and which has been certified by the State Commissioner of Financial Institutions as meeting the requirements of the Act and adhering to the rules of the State of Utah Money Management Council. The State of Utah Money Management Council has the responsibility to advise the State Treasurer about investment policies, promote measures and rules that will assist in strengthening the banking and credit structure of the State, and review the rules adopted under the authority of the Utah Money Management Act that relate to the deposit and investment of public funds. Deposits in the bank in excess of the insured amount are uninsured and uncollateralized.

The cash deposit balance for Federal-HIPUtah was \$377,854 at December 31, 2012. This consists of 1) cash held and administered by the State Treasurer as part of the State of Utah's general operating cash pool, 2) cash for premiums received by SelectHealth as Federal-HIPUtah's Plan Administrator, but not yet deposited in Federal-HIPUtah's bank account at December 31, 2012, and 3) cash from benefit claim payment reversals and refunds received by

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Notes to the Financial Statements For the Year Ended December 31, 2012

SelectHealth, but not yet refunded back to Federal-HIPUtah, less pharmacy claims paid by SelectHealth that have not been reimbursed by Federal-HIPUtah at December 31, 2012. This entire cash amount was uninsured and uncollateralized because it was either part of the bank deposits of the State in excess of the insured amount or were held in SelectHealth's bank account in their name and thus not insured for Federal-HIPUtah.

4. Accounts Payable

Accounts payable as of December 31, 2012, consisted of the following:

Plan Administrator Fees	\$ 32,174
Other Professional and Technical Services	<u>10,552</u>
Total Accounts Payable	<u>\$ 42,726</u>

5. Benefit Claim Liability

Changes in Federal-HIPUtah's benefit claims liability balances were as follows:

For the Year ended	Beginning Balance	Current Year Benefit Claims and Changes in Estimates	Benefit Claim Payments	Ending Balance
December 31, 2011	\$ 897,330	\$ 13,697,327	\$ 11,747,084	\$ 2,847,573
December 31, 2012	\$ 2,847,573	\$ 38,188,107	\$ 34,901,050	\$ 6,134,630