

An Audit

Health Insurance Risk-Sharing Plan

Department of Health and Family Services

2003-2004 Joint Legislative Audit Committee Members

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CONTENTS

Letter of Transmittal	1
Report Highlights	3
Introduction	11
Plan Provisions	11
Plan Funding	12
Audit Opinion	17
Independent Auditor's Report on the Financial Statements of the Wisconsin Health Insurance Risk-Sharing Plan	
Management's Discussion and Analysis	19
Financial Statements	25
Balance Sheet as of June 30, 2003 and 2002	26
Statement of Revenues, Expenses, and Changes in Net Assets for the Years Ended June 30, 2003 and 2002	27
Statement of Cash Flows for the Years Ended June 30, 2003 and 2002	28
Notes to the Financial Statements	29
Report on Compliance and Control	39
Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	
Appendix	
Payment of HIRSP Operating and Administrative Costs	
Response	
From the Department of Health and Family Services	



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April 14, 2004

Senator Carol A. Roessler and
Representative Suzanne Jeskewitz, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Roessler and Representative Jeskewitz:

At the request of the Department of Health and Family Services (DHFS), we have completed a financial audit of the Health Insurance Risk-Sharing Plan (HIRSP) for fiscal year (FY) 2002-03. HIRSP provides medical and prescription drug insurance for more than 17,000 policyholders who are unable to obtain coverage in the private market or who lost employer-sponsored group health insurance. We have provided an unqualified opinion on HIRSP's financial statements.

HIRSP's financial position continues to improve: its accounting deficit was \$0.9 million on June 30, 2003, compared to \$6.0 million on June 30, 2002. In addition, a balance in the excess policyholder premium account increased significantly during FY 2002-03, from \$3.0 million to \$10.4 million as of June 30, 2003. By statute, the excess premium balance can be used only for purposes that benefit policyholders, such as for reducing premium levels to a statutory floor of 140 percent of standard risk rates.

Despite an improving financial position, HIRSP faces continuing management and funding challenges because of increasing enrollment and claims costs. In FY 2002-03, enrollment increased 16.9 percent and claims costs increased 27.8 percent. In addition, general purpose revenue (GPR) support was eliminated beginning in FY 2003-04. Costs previously covered by GPR, which totaled \$10.2 million in FY 2002-03, are now covered by policyholders, insurers, and health care providers. Further, legislative action will be needed to address a technical issue that DHFS and HIRSP's contracted actuary have identified in HIRSP's statutory funding formula.

During our prior audit, we recommended DHFS increase its oversight of prescription drug claims, which totaled \$32.4 million in FY 2002-03, through independent audits of the pharmacy benefit management company's controls. DHFS is currently conducting a competitive procurement process to select the plan administrator that will be administering HIRSP beginning in January 2005, and it has included a requirement for such audits in the Request for Vendor Proposals that will be used to award a new contract.

We appreciate the courtesy and cooperation extended to us by DHFS and the plan administrator for HIRSP. A response from DHFS follows the appendix.

Respectfully submitted,

A handwritten signature in cursive script that reads 'Janice Mueller'.

Janice Mueller
State Auditor

JM/DA/ss

Report Highlights ■

HIRSP's financial position improved during FY 2002-03.

Policyholder enrollment and claims costs continue to increase.

The 2003-05 Biennial Budget Act included changes to HIRSP.

A technical issue in HIRSP's statutory funding formula needs legislative attention.

The Health Insurance Risk-Sharing Plan (HIRSP) was established in 1980 to provide medical insurance for individuals who cannot obtain coverage in the private market because of the severity of their health conditions. In the late 1990s, it was also designated as Wisconsin's plan to meet federal Health Insurance Portability and Accountability Act (HIPAA) regulations and to provide health insurance to people who lose employer-sponsored group health insurance and meet other specified criteria.

HIRSP is primarily funded through policyholder premiums; financial assessments on health insurance companies that do business in Wisconsin; reduced reimbursements to health care providers; and, until recently, general purpose revenue (GPR). As of February 29, 2004, 17,669 policyholders were enrolled in HIRSP.

HIRSP offers eligible applicants three plans:

- The primary plan, plan 1A, is similar to coverage provided by many private major medical plans.
- The alternative plan, plan 1B, offers the same coverage as plan 1A but at lower premium rates because policyholders pay a higher deductible before HIRSP begins paying claims.
- An additional plan, plan 2, is available to Wisconsin residents under the age of 65 who participate in the federal Medicare program because of a disability.

At the request of the Department of Health and Family Services (DHFS), we completed our sixth financial audit of HIRSP. Our audit report contains our unqualified opinion on HIRSP's financial statements and related notes for the fiscal years ending June 30, 2003 and 2002.

Financial Status of the Plan

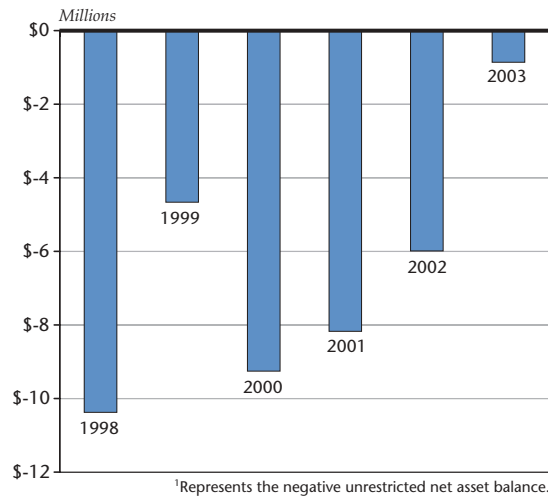
Because of its cash-based funding approach, HIRSP had an accounting deficit of \$8.2 million as of June 30, 2001. This deficit represented estimated additional cash that HIRSP would eventually need to pay covered medical expenses that had been incurred but not paid before this date.

DHFS and HIRSP's Board of Governors implemented an accrual-based approach to funding HIRSP beginning with fiscal year (FY) 2001-02. An accrual basis takes into account the full costs associated with events that occur during a plan year, including actuarial cost estimates for incurred claims that may not be filed until after the plan year. The change to an accrual-based approach required funding to eliminate the accounting deficit that had accumulated under the cash-based approach, as well as funding for newly incurred costs accounted for on an accrual basis.

As a result of increasing enrollment and program costs, as well as the change in the funding approach, policyholder premiums and insurer assessments increased significantly during FY 2001-02 and FY 2002-03. Total premium revenue almost doubled, while insurer assessments increased 162.7 percent. The increased revenues that resulted from increases in premiums and insurer assessments contributed to a \$5.1 million reduction in HIRSP's accounting deficit, which was \$0.9 million as of June 30, 2003. Changes in the accounting deficit since June 30, 1998, are shown in Figure 1.

Figure 1

HIRSP's Accounting Deficit¹
As of June 30



Statutes require policyholders to fund 60 percent of HIRSP's costs and establish a floor for policyholder premiums of at least 150 percent of standard risk rates through July 29, 2002, and 140 percent of standard risk rates as of July 30, 2002. Statutes also require a separate accounting of premiums received in excess of the amount needed to cover policyholders' 60 percent share of HIRSP's costs.

Because the statutory floor level for premium rates has typically been greater than the premiums needed to fund 60 percent of HIRSP's costs, and because actual claims costs were less than costs assumed in HIRSP's FY 2002-03 budget, the excess policyholder premium account balance increased significantly during FY 2002-03, from \$3.0 million to \$10.4 million as of June 30, 2003.

The use of these funds is statutorily restricted for these purposes:

- to reduce policyholder premiums to the statutory minimum when the policyholders' share of costs would otherwise require a premium increase;
- for other needs of eligible persons, with the approval of the Board of Governors; or
- for distribution to eligible persons.

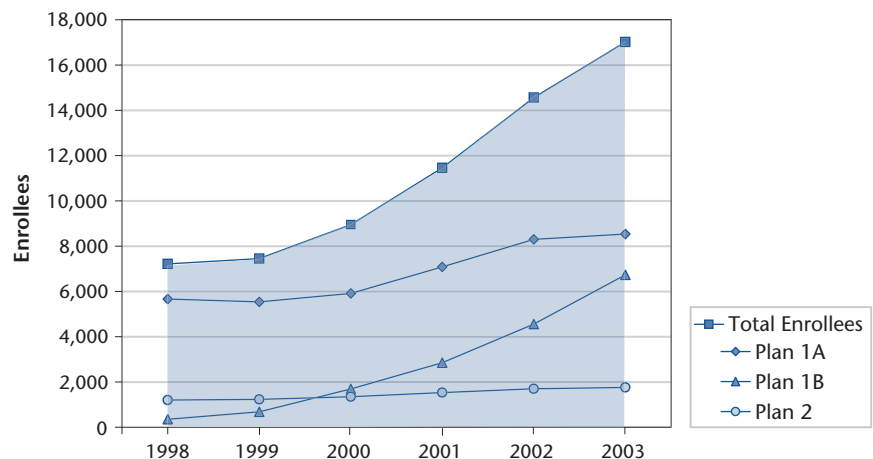
Increasing Enrollment and Claims Costs

Increasing enrollment and claims costs present continuing challenges to the management and funding of HIRSP. Policyholder enrollment increased 16.9 percent during FY 2002-03, to 17,017 policyholders as of June 30, 2003. However, enrollment experience during the first eight months of FY 2003-04 suggests that enrollment growth may be beginning to slow: enrollment increased by 3.8 percent, to 17,669 as of February 29, 2004.

As shown in Figure 2, enrollment in plans 1A and 2 began to level off in FY 2002-03, although enrollment in plan 1B continued to increase steadily. Further, an increasing number of participants have shifted from plan 1A to plan 1B in recent years. The greatest shift occurred in 2003, when 713 participants changed from plan 1A to plan 1B.

Figure 2

HIRSP Enrollment by Plan
As of June 30



Net of health care providers' discounts, claims costs increased 171.1 percent, or \$54.2 million, over the last five years. A large portion of these increases, shown in Table 1, can be explained by the enrollment increases, although HIRSP claims costs also have been affected by medical cost increases similar to those experienced by others in the health insurance industry.

Table 1
Claims Costs¹

Fiscal Year	Amount	Percentage Change
1998-99	\$31,671,704	–
1999-00	36,399,671	14.9%
2000-01	54,120,507	48.7
2001-02	67,180,778	24.1
2002-03	85,849,897	27.8

¹ Net of health care providers' discounts.

Legislative Activity

The Legislature began providing GPR funding to offset program costs in FY 1997-98. At that time, GPR funding to subsidize premiums and deductibles for low-income policyholders had been in place for several years. During the 2001-03 biennium, GPR support for HIRSP totaled \$21.0 million.

Under 2003 Wisconsin Act 33, the 2003-05 Biennial Budget Act, all GPR support for HIRSP was eliminated beginning in FY 2003-04. The other funding parties—policyholders, insurers, and health care providers—are now required to pay for costs that had previously been funded through GPR.

Act 33 also authorizes DHFS to select the HIRSP plan administrator through a competitive procurement process. Since 1998, statutes had required that the Medicaid fiscal agent serve as HIRSP's administrator. DHFS is currently conducting a competitive procurement process with the intent of selecting and contracting with a vendor to administer HIRSP beginning in January 2005, after a six-month transition period.

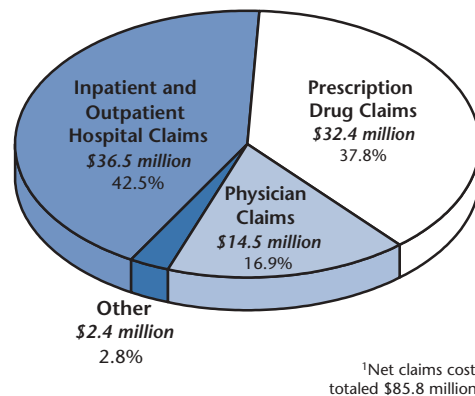
In light of HIRSP's increasing costs and the loss of GPR, legislation was introduced in February 2004 to expand the funding base to include drug manufacturers and drug labelers, which are companies that repackage prescription drugs for retail sale. Under 2003 Senate Bill 466, which was not enacted, each manufacturer or labeler that provided prescription drugs under HIRSP would have been required to pay an annual assessment based on claims that HIRSP

paid for their drugs in the previous calendar year. On a per claim basis, the assessment amount would have been equal to the rebate amount the drug manufacturer or labeler pays for the drug under Medicaid.

At 37.8 percent of net claims paid during FY 2002-03, prescription drug claims represent the second-largest portion of HIRSP’s claims costs, as shown in Figure 3. HIRSP currently receives some drug rebates as part of the agreement with its plan administrator, including \$677,118 during FY 2002-03.

Figure 3

Types of Claims Paid During FY 2002-03¹



Technical Statutory Issue

DHFS and HIRSP’s contracted actuary have identified a technical statutory issue that will require legislative action. Under current statutes, the method by which HIRSP’s funding formula applies deductible and drug coinsurance subsidies for low-income policyholders results in policyholders being over-credited for subsidies they did not fund, and a related portion of costs not being allocated to any funding party.

DHFS and the Board of Governors decided in 2001 that \$1.5 million of unallocated costs associated with the deductible subsidy credit would be paid by policyholders, insurers, and health care providers based on the statutory funding split used for HIRSP costs. These

costs had accumulated during 1998, 1999, and 2000. In March 2004, the Board's Financial Oversight Committee approved a recommendation to the Board to reduce the excess policyholder premium account by the amount of over-credited deductible subsidies as of March 31, 2004. The unallocated balance was \$2.1 million as of February 29, 2004. DHFS and the Board of Governors plan to pursue statutory changes to address this technical issue during the 2005-07 legislative session.

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Introduction ■

DHFS has been responsible for overseeing HIRSP since 1998. The 13-member Board of Governors advises DHFS on HIRSP's operations and includes members representing insurers, health care providers, and the public. At least one member of the Board must be a HIRSP policyholder. While the Board fills an advisory and oversight role, DHFS retains program rule-making authority, establishes the annual budget, and currently contracts with the State's fiscal agent for Medicaid to administer HIRSP. However, 2003 Wisconsin Act 33 eliminated a requirement that the plan administrator be the Medicaid fiscal agent, and DHFS is currently conducting a competitive procurement process to select the HIRSP plan administrator for the period beginning in January 2005, after a six-month transition period.

At the request of DHFS, we completed a financial audit of HIRSP for FY 2002-03. As necessary parts of the financial audit, we reviewed HIRSP's control procedures, assessed the fair presentation of the FY 2002-03 financial statements, and reviewed compliance with statutory provisions.

Plan Provisions

Three plans are available to policyholders.

HIRSP offers eligible applicants three plans:

- Plan 1A is available for Wisconsin residents who have received a notice of rejection, cancellation, reduction of coverage, or substantial premium increase by an insurer; who have tested positive

for the virus that causes AIDS; or who have lost employer-sponsored group health insurance and meet other specified criteria.

- Plan 1B is an alternative plan that was introduced in 1998 to comply with a federal HIPAA requirement to offer a choice of major medical expense coverage to the same individuals eligible for the primary plan.
- Plan 2 is available to Wisconsin residents under the age of 65 who participate in the federal Medicare program because of a disability. Persons with coverage when they reach the age of 65 may continue in the plan.

By statute, HIRSP may reimburse only those medical services that policyholders obtain through the State's Medicaid-certified providers. In addition to annual premiums, policyholders are required to share in the costs of covered services through:

- annual medical deductibles of \$1,000 for plan 1A, \$2,500 for plan 1B, and \$500 for plan 2, which must be paid by policyholders before insurance benefits will be available;
- medical coinsurance payments of 20 percent up to \$1,000 per year for policyholders in plans 1A and 1B, which must be paid by the policyholders after their annual deductible requirements have been satisfied (there is no coinsurance requirement for plan 2); and
- drug coinsurance payments of 20 percent, or \$25 maximum per drug, up to \$750 for plan 1A, \$1,000 for plan 1B, and \$125 for plan 2.

Plan Funding

Before January 1, 1998, HIRSP had two primary funding sources: premiums paid by policyholders, and annual financial assessments on health insurance companies that do business in Wisconsin. 1997 Wisconsin Act 27 authorized additional funding sources that took effect when oversight responsibility was transferred to DHFS on January 1, 1998. At the time, the Legislature:

- made additional GPR funding available to offset program costs, including \$10.0 million in FY 2001-02 and \$9.5 million in FY 2002-03; and
- required providers of covered health care items and services to share equally with insurers in program costs that were not covered by premiums and GPR. By statute, pharmacies have been excluded from the funding requirement for providers.

GPR support for HIRSP, which totaled \$21.0 million in the 2001-03 biennium, has been eliminated.

Until recently, the Legislature also continued GPR support to help fund premium and deductible subsidies for low-income policyholders. This support included \$780,800 in GPR for FY 2001-02, and \$741,800 for FY 2002-03. Insurers and health care providers shared equally in the subsidy costs that were not covered by GPR, which totaled \$3.9 million during FY 2002-03. GPR support for HIRSP totaled \$21.0 million in the 2001-03 biennium, but all GPR support was eliminated beginning in FY 2003-04.

Under HIRSP's complex statutory funding formula, which is illustrated in the appendix, policyholder premiums are required to fund 60 percent of the estimated operating and administrative costs. The remaining 40 percent are funded equally by private health insurers doing business in Wisconsin and health care providers providing medical services to HIRSP policyholders.

Premium rates for each of HIRSP's three plans differ on the basis of policyholders' gender, age, and geographic location and may range from not less than 140 percent to not more than 200 percent of standard rates. On average, premium rates for the primary plan have been at the minimum level, which was 150 percent of standard rates from January 1, 1998 through June 30, 2003, and 140 percent of standard rates since July 1, 2003. However, they were 161.9 percent of standard rates in FY 2001-02.

Rate increases for both plan 1A and plan 1B have been generally comparable to increases in the standard risk rates that private insurers would charge for individual insurance policies that provide substantially the same coverage and deductibles available under HIRSP. Table 2 shows premium rate changes since 1998. Plan 2, which is available for certain Medicare participants, typically experienced larger rate increases to more closely reflect that plan's claims costs. In response to concerns about increases in premiums for plan 2, statutes allow DHFS to consider enrollment levels and other economic factors in addition to claims costs when establishing premium levels. The ultimate goal of DHFS and the Board of Governors is to make the ratio of losses to premiums more consistent for all plans and to reduce the extent to which plans 1A and 1B are subsidizing plan 2.

Table 2
Premium Rate Changes

Effective Date	Plans 1A and 1B	Plan 2
July 1, 1998	11.4% increase	24.0% increase
January 1, 1999	No change	10.0% increase
July 1, 1999	No change	4.0% increase
July 1, 2000	12.4% increase	18.2% increase
July 1, 2001	3.4% increase	3.4% increase
July 1, 2002	25.4% increase	30.8% increase
July 1, 2003	10.6% increase	15.6% increase

Examples of annual premiums effective July 1, 2003, for policyholders living in Milwaukee, where the rates are the highest, are shown in Table 3.

Table 3
Examples of Annual Premiums for a Policyholder Living in Milwaukee
 Rates Effective July 1, 2003

Plan Type	Male Ages 0-24	Male Ages 60-64	Female Ages 0-18	Female Ages 60-64
Plan 1A	\$2,232	\$10,836	\$2,232	\$8,904
Plan 1B	1,608	7,800	1,608	6,408
Plan 2	1,716	8,280	1,716	6,804

In FY 2002-03, 23.7 percent of HIRSP policyholders received subsidies, at a cost of \$4.6 million.

Policyholders who are enrolled in plan 1A or plan 2 and who have annual household incomes below \$25,000 are eligible for premium subsidies. Policyholders enrolled in plan 1A with annual household incomes below \$20,000 are also eligible for deductible subsidies. Beginning January 1, 2002, plan 1A policyholders who are eligible for deductible subsidies are also eligible for drug coinsurance subsidies. In FY 2002-03, 23.7 percent of HIRSP policyholders received subsidies, at a cost of \$4.6 million.

DHFS and HIRSP's contracted actuary identified a technical issue relating to the treatment of deductible and drug coinsurance subsidies in the statutory funding formula. When the formula is applied, deductible and drug coinsurance subsidies are appropriately excluded from the costs that are allocated among all funding parties. The subsidies are then appropriately funded by insurers and providers. However, statutes also require that the subsidies be credited to policyholders when premiums are calculated. Therefore, deductible and drug coinsurance subsidy amounts are, in essence, double counted under the statutory funding formula; policyholders are inappropriately credited for subsidies each year; and, as result, a portion of HIRSP's annual costs is not allocated to any funding party.

DHFS and the Board of Governors decided in 2001 that \$1.5 million of unallocated costs associated with the deductible subsidy credit would be paid by policyholders, insurers, and health care providers based on the statutory funding split used for HIRSP costs. These costs had accumulated during 1998, 1999, and 2000. In March 2004, the Board's Financial Oversight Committee approved a recommendation to the Board to reduce the excess policyholder premium account by the amount of over-credited deductible subsidies as of March 31, 2004. The unallocated balance was \$2.1 million as of February 29, 2004. DHFS and the Board of Governors also plan to pursue statutory changes to address this technical issue during the 2005-07 legislative session.

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Audit Opinion ■

Independent Auditor's Report on the Financial Statements of the Wisconsin Health Insurance Risk-Sharing Plan

We have audited the accompanying financial statements of the Wisconsin Health Insurance Risk-Sharing Plan (HIRSP) as of and for the years ended June 30, 2003 and 2002. These financial statements are the responsibility of the Department of Health and Family Services' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements referred to in the first paragraph present only HIRSP and do not purport to, and do not, present fairly the financial position of the State of Wisconsin and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of HIRSP as of June 30, 2003 and 2002, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 14, HIRSP implemented a new financial reporting model for fiscal year 2001-02, as required by the provisions of Governmental Accounting Standards Board Statement Number 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments.

Our audits were conducted for the purpose of forming an opinion on the financial statements of HIRSP. The supplementary information included as Management’s Discussion and Analysis on pages 19 through 24 is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 2, 2004, on our consideration of HIRSP’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

April 2, 2004

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Diann Allsen
Audit Director

Management's Discussion and Analysis ■

Prepared by the Health Insurance Risk-Sharing Plan's Management

This section of the HIRSP annual financial report presents management's discussion and analysis of the financial performance of HIRSP. This discussion should be read in conjunction with the accompanying financial statements and notes. The financial statements, notes, and this discussion are the responsibility of HIRSP's management.

HIRSP was established in 1980. The purpose of HIRSP is to provide medical and prescription drug insurance for persons unable to obtain this insurance in the private market or who otherwise qualify for eligibility under s. 149.12, Wis. Stats.

Overview of Financial Statements

HIRSP prepares its financial statements in accordance with Governmental Accounting Standards Board (GASB) standards. For the fiscal year ended June 30, 2002, HIRSP implemented GASB Statement Number 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.

HIRSP's financial statements comprise two components: 1) the financial statements, and 2) notes to the financial statements that explain in more detail some of the information in the financial statements.

Following this section are the financial statements and notes as they relate to HIRSP.

- The Balance Sheet provides information on the types of assets and the liabilities of HIRSP, with the differences between the two reported as net assets. Over time, increases or decreases in net assets are an indicator of HIRSP's financial health.
- The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and the expenses incurred during the year on an accrual basis.
- The Statement of Cash Flows presents information related to cash inflows and outflows summarized by operating, noncapital financing, and investing activities and helps measure HIRSP's ability to meet financial obligations as they mature.
- The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. HIRSP uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. During FY 2002-03, the plan had two funding types: general purpose revenue (GPR), and program income in the form of segregated (SEG) funds.

For fiscal years ending June 30, 1998 through June 30, 2003, GPR revenues were received by HIRSP from the State of Wisconsin for general plan funding, as well as for premium and deductible subsidies for low-income policyholders. Prior to FY 1997-98, GPR funding was only available for premium and deductible subsidies. Starting in FY 2003-04, no GPR funding was appropriated for HIRSP for either general plan funding or premium and deductible subsidies for low-income policyholders.

Program income is received by HIRSP from policyholders and insurers. Health care providers contribute to HIRSP by accepting a reduction in fees for their services. Section 149.143, Wis. Stats., prescribes a funding formula for HIRSP that requires policyholders, private health insurers, and health care providers, except pharmacies, to share in plan costs remaining after GPR appropriated under s. 20.435(4)(af), Wis. Stats., is deducted. Pharmacies are specifically exempt from contributing to HIRSP as provided by s. 149.142(1)(b), Wis. Stats.

Premiums, which before July 30, 2002, were statutorily required to be at least 150 percent of standard risk rates, are to fund 60 percent of these estimated costs, as long as the necessary premium rates do not exceed 200 percent of standard risk rates. 2001 Wisconsin Act 109 lowered the minimum premium level from 150 percent to 140 percent of the standard risk rate, effective July 30, 2002. Private health insurers doing business in Wisconsin and health care providers (except pharmacies) providing medical services to HIRSP policyholders are to share equally in:

- costs remaining after any GPR appropriated under s. 20.435(4)(af), Wis. Stats., and after the deduction of the policyholders' share of the costs;
- premium, deductible, and drug coinsurance subsidy costs in excess of any GPR appropriated under s. 20.435(4)(ah), Wis. Stats., for that purpose; and
- excess costs when premium rates needed to fund 60 percent of costs exceed 200 percent of premium rates for standard risks. However, between FY 1997-98 and FY 2003-04, the highest HIRSP rates have been 161.9 percent of the standard risk rate.

Financial Analysis of HIRSP

In this discussion and analysis, the reasons for the changes in financial activity between FY 2002-03 and FY 2001-02 are reviewed. Net assets may serve over time as a useful indicator of the financial position of HIRSP. In the case of HIRSP, assets exceeded liabilities by \$9,530,521 at the close of the fiscal year ending June 30, 2003, an improvement of \$12,496,044 over total net assets as of June 30, 2002.

Condensed Financial Information

	June 30, 2003	June 30, 2002	Percentage Change
Total Assets	\$42,058,260	\$27,540,481	52.7%
Total Liabilities	<u>32,527,739</u>	<u>30,506,004</u>	6.6
Net Assets:			
Restricted	10,418,274	3,040,220	242.7
Unrestricted	(887,753)	(6,005,743)	85.2
Total Net Assets	<u>\$9,530,521</u>	<u>\$(2,965,523)</u>	421.4

	FY 2002-03	FY 2001-02	Percentage Change
Operating Revenues	\$92,371,493	\$62,995,554	46.6%
Operating Expenses	(90,462,180)	(71,069,074)	27.3
Nonoperating Revenues	10,586,731	11,153,426	(5.1)
Change in Net Assets	<u>\$12,496,044</u>	<u>\$ 3,079,906</u>	305.7

The largest portion of HIRSP's total assets, 95.7 percent, is in the form of cash and cash equivalents. HIRSP uses cash to pay current operating expenses. Cash in excess of immediate needs is invested in short-term investments with the State of Wisconsin Investment Board.

The largest area of HIRSP's liabilities is unpaid loss liabilities. Unpaid loss liabilities represent the accumulation of losses, net of discounts from providers, that were reported but not paid prior to the close of the accounting period, and an actuarial estimate of claims incurred prior to June 30 but not reported. Consequently, cash is reserved for payment of these future claims.

HIRSP's net assets increased by \$12,496,044 during FY 2002-03. Net assets restricted for excess policyholder premiums accounted for \$7,378,054 of this increase. HIRSP's revenues consist of GPR funds, policyholder premiums, and insurer assessments. HIRSP uses these revenues to pay operating expenses. HIRSP revenues, combined with reduced payments to health care providers, were sufficient to cover all operating expenses of the program during FY 2002-03.

Financial Highlights

- Plan enrollment as of June 30, 2003, was 17,017, an increase of 16.9 percent over June 30, 2002 enrollment of 14,563. As a result of the enrollment increase:
 - Premium revenues increased.
 - Insurer assessments increased.
 - Claims expense (net of health care providers' discounts) increased.
- Revenue from the State of Wisconsin decreased 5.0 percent.
- Plan operations are conducted by DHFS staff, as well as a third-party contract administrator.
 - Total administrative costs for FY 2002-03 were \$4,460,955, up 17.9 percent from \$3,784,699 in FY 2001-02.
 - Total administrative costs were 4.9 percent of program costs for FY 2002-03, a decrease from 5.3 percent of program costs for FY 2001-02.
 - The following chart shows plan costs for claims and administrative expenses on a per member per month (PMPM) basis:

Cost Summary on a per Member per Month (PMPM) Basis
FY 2001-02 and FY 2002-03

Description	FY 2001-02	FY 2002-03	FY 2001-02 PMPM	FY 2002-03 PMPM	Percentage Change
Member Months (Total Members Enrolled in Each Month of Fiscal Year)	157,970	192,654	-	-	22.0%
Gross Claims (Costs before Provider Contributions Were Deducted)	\$82,938,495	\$112,009,977	\$525.03	\$581.40	10.7 %
Administrative Expenses	\$ 3,784,699	\$ 4,460,955	\$ 23.96	\$ 23.16	-3.3 %

- HIRSP's change in net assets increased.
 - The change in net assets was \$12,496,044, an improvement of over \$9.4 million from the \$3,079,906 change in FY 2001-02.
 - Investment income declined from \$372,626 in FY 2001-02 to \$349,551 in FY 2002-03, largely due to continued declining investment returns.
- Net assets are split between restricted and unrestricted.
 - Restricted net assets for excess policyholder premiums increased from \$3,040,220 to \$10,418,274. This increase of \$7,378,054 was primarily the result of actual claim expenses being less than anticipated at the time the budget was set, and the premium floor being at 150 percent of standard risk rates for the fiscal year. The restricted net assets are statutorily required under s. 149.143(2m)(b), Wis. Stats., to be used 1) to reduce policyholder premiums to a floor of 150 percent (140 percent effective July 30, 2002) of standard risk rates when premiums exceed the policyholders' share of plan costs; 2) for other needs of eligible persons, with the approval of the Board of Governors; or 3) for distribution to eligible persons.

- Unrestricted net assets improved as well, from (\$6,005,743) to (\$887,753). Unrestricted net assets represent the estimated amount of additional cash that HIRSP would need to pay its liabilities as of fiscal year-end.

Contacting the Plan's Financial Management

The financial report is designed to provide a general overview of HIRSP finances for all those with an interest. Questions concerning any of the information provided in this report, or requests for additional information, should be addressed to:

Sally A. Acuff, Audit Liaison
Department of Health and Family Services
Room 655, 1 West Wilson Street
P.O. Box 7850
Madison, WI 53707-7850

General information relating to HIRSP can be found at the HIRSP Web site, <http://www.dhfs.state.wi.us/hirsp/index.htm>.

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Financial Statements ■

Balance Sheet
June 30, 2003 and 2002

	<u>June 30, 2003</u>	<u>Restated June 30, 2002</u>
ASSETS		
Cash and Cash Equivalents (Note 2)	\$ 40,264,885	\$ 24,958,974
Assessments Receivable (Note 3)	167,035	278,103
Other Receivables (Note 3)	1,543,300	2,244,142
Prepaid Items	83,040	59,262
TOTAL ASSETS	<u>\$ 42,058,260</u>	<u>\$ 27,540,481</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Unpaid loss liabilities (Note 4)	\$ 14,887,195	\$ 14,674,153
Unpaid loss adjustment expenses (Note 4)	660,000	621,900
Unearned premiums	13,609,566	10,470,731
Liability for premium overpayments (Note 5)	471,488	471,488
Accounts payable and other accrued liabilities (Note 3)	2,899,490	4,267,732
Total Liabilities	<u>32,527,739</u>	<u>30,506,004</u>
Net Assets:		
Restricted for excess policyholder premiums (Notes 6 and 15)	10,418,274	3,040,220
Unrestricted (Notes 12 and 15)	(887,753)	(6,005,743)
Total Net Assets	<u>9,530,521</u>	<u>(2,965,523)</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 42,058,260</u>	<u>\$ 27,540,481</u>

The accompanying notes are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Net Assets for the Years Ended June 30, 2003 and 2002

	For the Year Ended June 30, 2003	For the Year Ended June 30, 2002
OPERATING REVENUES		
Premiums	\$ 66,368,223	\$ 43,375,232
Insurers' Assessments (Note 7)	26,003,270	19,620,322
Total Operating Revenues	92,371,493	62,995,554
OPERATING EXPENSES		
Losses:		
Losses paid or approved for payment (Note 11)	84,283,858	70,627,947
Increase (decrease) in unpaid losses	1,566,039	(3,447,169)
Total Losses	85,849,897	67,180,778
Change in Unpaid Loss Adjustment Expenses	38,100	0
General and Administrative Expenses (Note 10)	4,460,955	3,784,699
Referral Fees	113,228	103,597
Total Operating Expenses	90,462,180	71,069,074
OPERATING INCOME (LOSS)	1,909,313	(8,073,520)
NONOPERATING REVENUES AND EXPENSES		
Revenue from the State of Wisconsin	9,500,000	10,000,000
State Premium and Deductible Subsidies (Note 9)	741,800	780,800
Investment Income	349,551	372,626
Transfer to the General Fund	(4,620)	0
Total Nonoperating Income	10,586,731	11,153,426
CHANGE IN NET ASSETS	12,496,044	3,079,906
NET ASSETS		
Total Net Assets—Beginning of the Year	(2,965,523)	(6,045,429)
Total Net Assets—End of the Year	\$ 9,530,521	\$ (2,965,523)

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2003 and 2002

	For the Year Ended June 30, 2003	For the Year Ended June 30, 2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received for Premiums	\$ 70,356,312	\$ 46,728,384
Cash Received for Assessments	26,114,337	19,377,658
Cash Payments for Losses	(87,071,251)	(66,910,922)
Cash Payments for Other Expenses	(4,684,838)	(4,029,249)
Net Cash Provided (Used) by Operating Activities	4,714,560	(4,834,129)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Cash Received from the State of Wisconsin	10,241,800	10,780,800
Net Cash Provided by Noncapital Financing Activities	10,241,800	10,780,800
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Income	349,551	372,626
Net Cash Provided by Investing Activities	349,551	372,626
NET INCREASE IN CASH AND CASH EQUIVALENTS	15,305,911	6,319,297
Cash and Cash Equivalents—Beginning of the Year	24,958,974	18,639,677
Cash and Cash Equivalents—End of the Year	<u>\$ 40,264,885</u>	<u>\$ 24,958,974</u>
RECONCILIATION OF NET OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Net Operating Income (Loss)	\$ 1,909,313	\$ (8,073,520)
Adjustments to Reconcile Net Operating Loss to Net Cash Provided by Operating Activities:		
Changes in assets and liabilities:		
Decrease (increase) in receivables	811,910	2,311,484
Decrease (increase) in prepaids	(23,778)	(50)
Increase (decrease) in liability for premium overpayments	0	471,488
Increase (decrease) in accounts payable	(1,368,242)	(101,760)
Increase (decrease) in unearned premiums	3,138,835	3,052,235
Increase (decrease) in loss liabilities	251,142	(2,494,006)
Other adjustments	(4,620)	0
Total Adjustments	2,805,247	3,239,391
Net Cash Used by Operating Activities	\$ 4,714,560	\$ (4,834,129)

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements ■

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of the Fund

The Wisconsin Health Insurance Risk-Sharing Plan (HIRSP), which is part of the State of Wisconsin financial reporting entity and is reported as an enterprise fund in the State's Comprehensive Annual Financial Report, was established in 1980. The purpose of HIRSP is to provide medical insurance for persons unable to obtain this insurance in the private market or who otherwise qualify for eligibility under s. 149.12, Wis. Stats.

Effective January 1, 1998, HIRSP was transferred from the State of Wisconsin Office of the Commissioner of Insurance to the State of Wisconsin Department of Health and Family Services (DHFS). DHFS uses independent third-party administrators to provide underwriting, claims settlement, actuarial, and administrative services.

Section 149.143, Wis. Stats., prescribes a funding formula for HIRSP that requires policyholders, private health insurers, and health care providers to share in estimated costs remaining after general purpose revenue (GPR) appropriated under s. 20.435(4)(af), Wis. Stats., is deducted. Plan 1A and 1B premiums, which before July 30, 2002, were statutorily required to be at least 150 percent of standard risk rates, are to fund 60 percent of these estimated costs, as long as the necessary premium rates do not exceed 200 percent of standard risk rates. 2001 Wisconsin Act 109 lowered the minimum premium level from 150 percent to 140 percent of the standard risk rate, effective July 30, 2002. Plan 2

premiums are established using criteria outlined in s. 149.14 5(m), Wis. Stats.: 1) comparison of cost per capita for plans 1A and 2 in the previous calendar year; 2) enrollment levels of eligible persons in plans 1A and 2; and 3) economic factors DHFS and the Board of Governors consider relevant.

Private health insurers doing business in Wisconsin and health care providers providing medical services to HIRSP policyholders are to share equally in:

- costs remaining after any GPR appropriated under s. 20.435(4)(af), Wis. Stats., and after the deduction of the policyholders' share of the costs;
- premium, deductible, and drug coinsurance subsidy costs in excess of any GPR appropriated under s. 20.435(4)(ah), Wis. Stats., for that purpose; and
- excess costs when premium rates needed to fund 60 percent of costs exceed 200 percent of premium rates for standard risks.

B. Basis of Presentation and Accounting

The accompanying financial statements of HIRSP have been prepared in conformity with generally accepted accounting principles for governments as prescribed by the Governmental Accounting Standards Board (GASB).

The accompanying financial statements were prepared based upon the flow of economic resources measurement focus and the full accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the accounting period in which they are earned and become measurable, and expenses are recognized in the period incurred if measurable. Financial Accounting Standards Board statements effective after November 30, 1989, are not applied in accounting for HIRSP's operations.

Operating revenues and expenses are directly related to the ongoing medical insurance activities of HIRSP. Nonoperating revenues and expenses are indirectly related to the ongoing medical insurance activities of HIRSP, such as investment income. Certain significant revenue streams relied upon by operations are reported as nonoperating revenue, as defined by GASB Statement Number 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, including state general appropriations.

C. Accounting Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ

from those estimates. Estimates that are particularly susceptible to significant change are the unpaid loss liabilities as described in Notes 1E and 4 and the provider contributions as described in Note 11. In estimating these items, management used the methodologies discussed in the applicable notes.

D. Cash and Cash Equivalents

Cash and cash equivalents reported on the Balance Sheet and the Statement of Cash Flows include a demand deposit account at a commercial financial institution and cash deposited with the State Treasurer, where available balances beyond immediate needs are pooled in the State Investment Fund for short-term investment purposes. Balances pooled are restricted to legally stipulated investments. These investments are valued consistent with GASB Statement Number 31, Accounting and Financial Reporting for Investments and for External Investment Pools.

E. Unpaid Loss Liabilities

Unpaid loss liabilities represent the accumulation of losses, net of discounts to provider payments, reported but not paid prior to the close of the accounting period and estimates of claims incurred prior to June 30 but not reported. The unpaid loss liabilities are established by an independent actuary and are based on historical patterns of claim payments. Such liabilities are necessarily based on estimates and, while management believes the results of the estimates are materially correct, the ultimate liabilities may be in excess or less than the amounts provided due to uncertainties inherent in the estimation process. The method and assumptions used in making such estimates are periodically reviewed and updated, with resulting adjustments to the liabilities reflected in current operations. The unpaid loss adjustment expense is the anticipated cost for processing claims related to the unpaid loss liabilities.

F. Premium and Assessment Revenue

Premiums are recognized as revenues over the terms of the insurance policies, and a liability for unearned premiums is established to reflect premiums received applicable to subsequent accounting periods. Participating insurers are assessed every six months, and revenue is recognized over the period covered by the assessment. Insurer assessments are determined annually during the budgeting process and split into two installments.

G. Policy Acquisition Costs

HIRSP has no marketing staff and incurs no sales commissions. Policy acquisition costs are minimal and expensed as incurred. Insurance agents who assist individuals with the HIRSP application process are paid a one-time referral fee in the amount of \$35 for each policy issued.

2. DEPOSITS

GASB Statement Number 3 requires deposits with financial institutions to be categorized to indicate the level of risk assumed by the State at year-end. The risk categories for deposits are:

- category 1: insured or collateralized with securities held by HIRSP or by its agent in HIRSP’s name;
- category 2: uninsured but collateralized by the financial institution; and
- category 3: uninsured and uncollateralized.

HIRSP’s cash balances are maintained in a public funds checking account with a commercial financial institution and with the State of Wisconsin Investment Board. The carrying amount of the demand deposits with the financial institution was \$1,256,659 at June 30, 2003, and \$897,099 at June 30, 2002. The bank balance was \$1,252,504 at June 30, 2003, and \$1,516,084 at June 30, 2002. The Federal Deposit Insurance Corporation and the Wisconsin State Deposit Guarantee Fund (s. 34.08, Wis. Stats.) cover state deposits. Of the bank balance at June 30, 2003, and June 30, 2002, \$400,000 was insured and classified in risk category 1; \$852,504 at June 30, 2003, and \$1,116,084 at June 30, 2002, was uninsured and uncollateralized and was classified in risk category 3.

The State of Wisconsin Investment Board, through the State Investment Fund, invests cash deposited with the State of Wisconsin Treasurer. The carrying amount of shares in the State Investment Fund, which approximates market value, was \$38,674,192 as of June 30, 2003, and \$23,679,096 as of June 30, 2002.

Holdings of the State Investment Fund include certificates of deposit and investments consisting primarily of direct obligations of the federal government and the State, and unsecured notes of qualifying financial and industrial issuers. Shares in the State Investment Fund are not required to be categorized under GASB Statement Number 3. The State Investment Fund is not registered with the Securities and Exchange Commission.

3. RECEIVABLE AND PAYABLE DETAIL

Significant receivable balances as of June 30, 2003, include the following:

Assessments Receivable	\$ 167,035
Other Receivables:	
Drug Rebates	571,544
Claims Receivable	424,009
Due from the State of Wisconsin	418,324
Miscellaneous Receivables	<u>129,423</u>
Total	\$1,543,300

\$109,195 of the insurers' assessments receivable balance is not expected to be collected within the following fiscal year. While the plan expects to receive all drug rebates receivable, it typically takes more than one year for final settlement to occur. \$253,999 of the claims receivable balance is greater than two years old, and \$228,600 is not expected to be collected in the following fiscal year. The remaining claims receivable balance of \$170,010 is less than two years old, and \$102,006 is not expected to be collected in the following fiscal year.

Significant payable and other accrued liability balances as of June 30, 2003, include the following:

Payments to Providers	\$1,950,069
Accrued Administrative Expenses	759,030
Miscellaneous Payables	<u>190,391</u>
Total	\$2,899,490

4. LIABILITY FOR UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

The following represents changes in the combined unpaid loss liabilities and unpaid loss adjustment expense liability account balances for FYs 2002-03 and 2001-02 (in thousands):

	<u>FY 2002-03</u>	<u>FY 2001-02</u>
Balance, Beginning of Year	<u>\$15,296</u>	<u>\$17,790</u>
Incurred Claims:		
Provision for insured events of the current fiscal year	90,904	75,553
Changes in provision for insured events of prior fiscal years	<u>(3,815)</u>	<u>(7,035)</u>
Total Incurred	<u>87,089</u>	<u>68,518</u>
Payments:		
Claims attributable to insured events of the fiscal year	76,344	61,161
Claims attributable to insured events of prior fiscal years	<u>10,494</u>	<u>9,851</u>
Total Paid	<u>86,838</u>	<u>71,012</u>
Balance, End of Year	<u>\$15,547</u>	<u>\$15,296</u>

5. LIABILITY FOR PREMIUM OVERPAYMENTS

During the calculation of premium rates for FY 2001-02, an error caused subsidized policyholders to overpay \$700,000 in premiums. (See Note 9 for a description of subsidies.) According to s. 149.165, Wis. Stats., premium rates for subsidized policyholders should be set at a specific percentage of the standard rate according to household income. Instead, the subsidized premium rates for FY 2001-02 were incorrectly increased at the same rate as the unsubsidized premium rates. The HIRSP Board of Governors voted on September 10, 2003, to issue a premium refund to policyholders who received a subsidy in FY 2001-02 and are currently active. This action resulted in an accrued liability of \$471,488 on June 30, 2002 and 2003. These refunds were paid in December 2003.

6. NET ASSETS RESTRICTED FOR EXCESS POLICYHOLDER PREMIUMS

Section 149.143(2m)(a), Wis. Stats., requires DHFS to keep a separate accounting of the difference between premiums received during a plan year and the amount of premiums necessary to cover policyholders' 60 percent share of plan costs for that plan year. The use of these funds is restricted under s. 149.143(2m)(b), Wis. Stats., as follows: 1) to reduce policyholder premiums to a floor of 150 percent (140 percent effective July 30, 2002) of standard risk rates when premiums exceed the policyholders' share of plan costs; 2) for other needs of eligible persons, with the approval of the Board of Governors; or 3) for distribution to eligible persons.

7. INSURERS' ASSESSMENTS

Statutes prescribe that participating insurers contribute 20 percent of general HIRSP costs and 50 percent of the subsidy costs not funded by GPR. Each participating insurer shares in the costs of HIRSP in proportion to the ratio of the insurer's total health care coverage revenue for Wisconsin residents to the aggregate health care coverage revenue of all participating insurers for Wisconsin residents. Insurers writing health insurance in Wisconsin are required to report the annual amount of accident and health insurance premiums earned to the Commissioner of Insurance, and assessments based on percentages derived from these reports are made every six months.

8. DRUG COINSURANCE OUT-OF-POCKET MAXIMUMS

As of January 1, 2002, HIRSP prescription drug benefits changed. Under the new benefit program, policyholders are responsible for a 20 percent coinsurance payment up to a maximum of \$25 per prescription. HIRSP will pay the remainder of the allowed amount directly to the pharmacy.

The drug coinsurance benefit also has an annual out-of-pocket maximum, which varies by plan and option. Once the drug coinsurance out-of-pocket maximum is reached, HIRSP pays 100 percent of the allowed amount for the remainder of the calendar year. Plan 1A policyholders who qualify for deductible reductions also qualify for reductions in drug coinsurance out-of-pocket maximums. The reduced drug coinsurance out-of-pocket maximum will be based on the reduced medical deductible for which the policyholder qualifies. The table that follows provides details. Note 9 further discusses the drug coinsurance subsidies provided in FY 2002-03 and FY 2001-02.

<u>Plan</u>	<u>Medical Deductible</u>	<u>Drug Coinsurance Out-of-Pocket Maximum</u>
1A	\$1,000	\$ 750
	800	600
	700	525
	600	450
	500	375
1B	2,500	1,000
2	500	125

The amounts paid toward prescription drugs under this benefit do not apply to the medical deductible, medical coinsurance, or medical out-of-pocket maximums.

9. PREMIUM, DEDUCTIBLE, AND DRUG COINSURANCE SUBSIDIES

HIRSP provides a premium, deductible, and drug coinsurance subsidy program to reduce premiums, deductible levels, and out-of-pocket costs for prescription drugs for low-income policyholders. This program varies by plan and option. HIRSP policyholders enrolled in plan 1A or plan 2 who have annual household incomes below \$25,000 are eligible for a premium subsidy. No premium subsidy is available for policyholders enrolled in plan 1B. Policyholders enrolled in plan 1A with incomes below \$20,000 are also eligible for a deductible subsidy. No deductible subsidy is available for policyholders enrolled in plan 1B or plan 2. Note 8 further discusses the drug coinsurance subsidies that are also provided to plan 1A policyholders.

HIRSP premiums for plan 1A and 1B are based on standard risk rates; that is, the rates private insurers would charge for individual insurance policies providing substantially the same coverage and deductibles as provided under HIRSP. Individuals not eligible for a premium subsidy have generally been paying 150 percent of the rate a standard risk would pay in recent years, although premiums can be increased to 200 percent of standard risk if necessary to meet requirements of the funding formula. In FY 2002-03, premium rates for the primary plan were set at 150 percent of the rate a standard risk would pay.

Individuals enrolled in plan 1A or plan 2 who are eligible for the subsidy program pay premiums based on reduced percentages of standard risk, as shown in the following table.

<u>Annual Household Income</u> <u>at Least</u>	<u>but Less Than</u>	<u>Amount of Premium</u> <u>as Percentage of</u> <u>Standard Risk Rates</u>	<u>Reduction in</u> <u>Deductible for</u> <u>Plan 1A Participants</u>
\$ 0	\$10,000	100.0%	\$500
10,000	14,000	106.5	400
14,000	17,000	115.5	300
17,000	20,000	124.5	200
20,000	25,000	130.0	N/A

Twenty-four percent of HIRSP policyholders received premium, deductible, and drug coinsurance subsidies totaling \$4,634,397 in FY 2002-03 and \$2,553,363 in FY 2001-02. The following table summarizes the amounts provided for each subsidy type during these years.

<u>Subsidy Type</u>	<u>FY 2002-03</u>	<u>FY 2001-02</u>
Premium	\$3,974,005	\$1,918,393
Deductible	534,858	624,910
Drug Coinsurance ¹	<u>125,534</u>	<u>10,060</u>
Total	\$4,634,397	\$2,553,363

¹The FY 2001-02 amount is for the six months ending June 30, 2002.

GPR appropriated and spent for premium and deductible subsidies was \$741,800 in FY 2002-03 and \$780,800 in FY 2001-02. No GPR was specifically appropriated for drug coinsurance subsidies in either year. Prior to January 1, 2002, the HIRSP deductible applied to prescription drug and medical claims. Therefore, prescription drug claims were subsidized through the deductible reduction program. Costs in excess of GPR appropriated for this purpose were shared equally by health insurers and health care providers, with each contributing \$1,946,299 in FY 2002-03 and \$886,282 in FY 2001-02. Pharmacies are exempt from contributing toward these costs.

10. GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses include the following:

	<u>FY 2002-03</u>	<u>FY 2001-02</u>
Plan Administrator Fees	\$3,588,355	\$3,170,135
State Administrative Costs	388,715	358,460
Postage	175,984	180,291
HIPAA Implementation	290,075	0
Other Expenses	<u>17,826</u>	<u>75,813</u>
Total	\$4,460,955	\$3,784,699

In January 2002, the plan administrator rescinded administrative invoices totaling \$447,081 that had been accrued as of June 30, 2001. As a result, the expense for plan administrator fees was reduced by \$447,081 during FY 2001-02.

11. HEALTH CARE PROVIDERS' CONTRIBUTIONS

Statutes prescribe that health care providers, except pharmacies, contribute 20 percent of general HIRSP costs and 50 percent of the subsidy costs not funded by GPR. Provider contributions are obtained by reducing the amount providers are reimbursed for billed services. The provider contribution is not reported as revenue in the financial statements, but rather reduces the amount of paid losses, which are reported net of the contributions on the financial statements. Disclosure of the provider contribution amount is important for full disclosure of HIRSP's funding sources and to demonstrate compliance with the statutory funding formula.

DHFS estimates the provider contributions attributable to funding HIRSP were \$26,160,080 for FY 2002-03 and \$15,757,717 for FY 2001-02. The contributions are based on actuarially developed estimates of reimbursement levels under the HIRSP program prior to January 1998. Although management believes the results of the estimates are materially correct, due to uncertainties inherent in estimates the actual provider contribution may be in excess or less than the amount estimated. DHFS and the Board of Governors used these provider contribution amounts to assess whether providers were providing their required level of funding for HIRSP.

12. NET ASSETS

Negative unrestricted net assets have resulted, in large part, because prior to FY 2001-02, HIRSP had been funded on a cash basis, in which funding levels were based on estimated cash disbursements and had the goal of providing sufficient revenues to pay claims as they were submitted, but limiting the accumulation of cash beyond current needs. Beginning in FY 2001-02, HIRSP's funding is on an accrual basis, which takes into account the total costs associated with events that occurred during the plan year, including actuarial cost estimates for claims that have been incurred but will not be paid until after the end of the plan year.

13. SUBSEQUENT EVENT

With the enactment of 2003 Wisconsin Act 33, the 2003-05 Biennial Budget Act, all GPR support for HIRSP, including support for program and subsidy costs, is eliminated, beginning with FY 2003-04.

14. CHANGE IN ACCOUNTING PRINCIPLE

HIRSP implemented a new financial reporting model, as required by the provisions of GASB Statement Number 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, as of June 30, 2002. This statement's requirements represent a significant change in the financial model used by state governments, including statement formats and changes in fund types.

Some of the major changes in HIRSP's financial presentation under GASB 34 included reclassifying revenues not related to HIRSP's primary purpose from operating to nonoperating, recording net assets as restricted or unrestricted, and adding management's discussion and analysis of HIRSP's financial operations.

15. PRIOR-PERIOD ADJUSTMENT

Due to the mistaken application of the premium overpayment liability discussed in Note 5, the FY 2001-02 net assets restricted for excess policyholder premiums was incorrectly reduced by the liability of \$471,488. Instead, unrestricted net assets should have been reduced by this amount. The FY 2001-02 statements have been restated to reflect this correction.

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Report on Compliance and Control ■

Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

We have audited the financial statements of the Wisconsin Health Insurance Risk-Sharing Plan (HIRSP) as of and for the years ended June 30, 2003, and June 30, 2002, and have issued our report thereon dated April 2, 2004. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

COMPLIANCE

As part of obtaining reasonable assurance about whether HIRSP's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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 that are required to be reported under *Government Auditing Standards*.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the Department of Health and Family Services' (DHFS's) internal control over HIRSP's financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements, and not to provide assurance on the internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be a material weakness. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be a material weakness.

However, as noted during our prior audit (report 03-12), oversight of HIRSP could be improved if periodic reviews of the internal controls of the pharmacy benefit management company were completed. Entities such as claims processing organizations that provide similar services to several organizations often obtain special independent external reviews of their controls to fulfill the needs of the various user organizations they serve and the user organizations' auditors. These reviews, which are commonly referred to as "SAS 70" service organization audits, provide an in-depth audit of a service organization's control activities and their operating effectiveness. For example, HIRSP's plan administrator regularly obtains a SAS 70 report for its clients and their auditors to rely upon. However, the pharmacy benefit management company contracted by the HIRSP plan administrator to process prescription drug claims beginning in FY 2001-02 does not obtain, nor is required by DHFS or the plan administrator to obtain, an external SAS 70 review of its internal controls.

Because prescription drug claims, which were \$23.1 million during FY 2001-02 and \$32.4 million during FY 2002-03, represent a large portion of HIRSP's claims expenses, it is important that the internal controls in place at the pharmacy benefit management company are sound and working as intended. In response to recommendations made during the prior audit, DHFS plans to incorporate into its future contract for a plan administrator a requirement for a SAS 70 audit or alternative steps to provide independent reviews of controls over prescription drug claims. It specified the audits as a requirement in the Request for Vendors' Proposals, which will be used to award a new contract.

This independent auditor's report is intended for the information and use of DHFS's management and the Wisconsin Legislature. This independent auditor's report, upon submission to the Joint Legislative Audit Committee, is a matter of public record and its distribution is not limited. However, because we do not express an opinion on compliance or provide assurance on internal control over financial reporting, this report is not intended to be used by anyone other than these specified parties.

April 2, 2004

LEGISLATIVE AUDIT BUREAU

A handwritten signature in cursive script that reads "Diann Allsen".

Diann Allsen
Audit Director

Appendix

Payment of HIRSP Operating and Administrative Costs

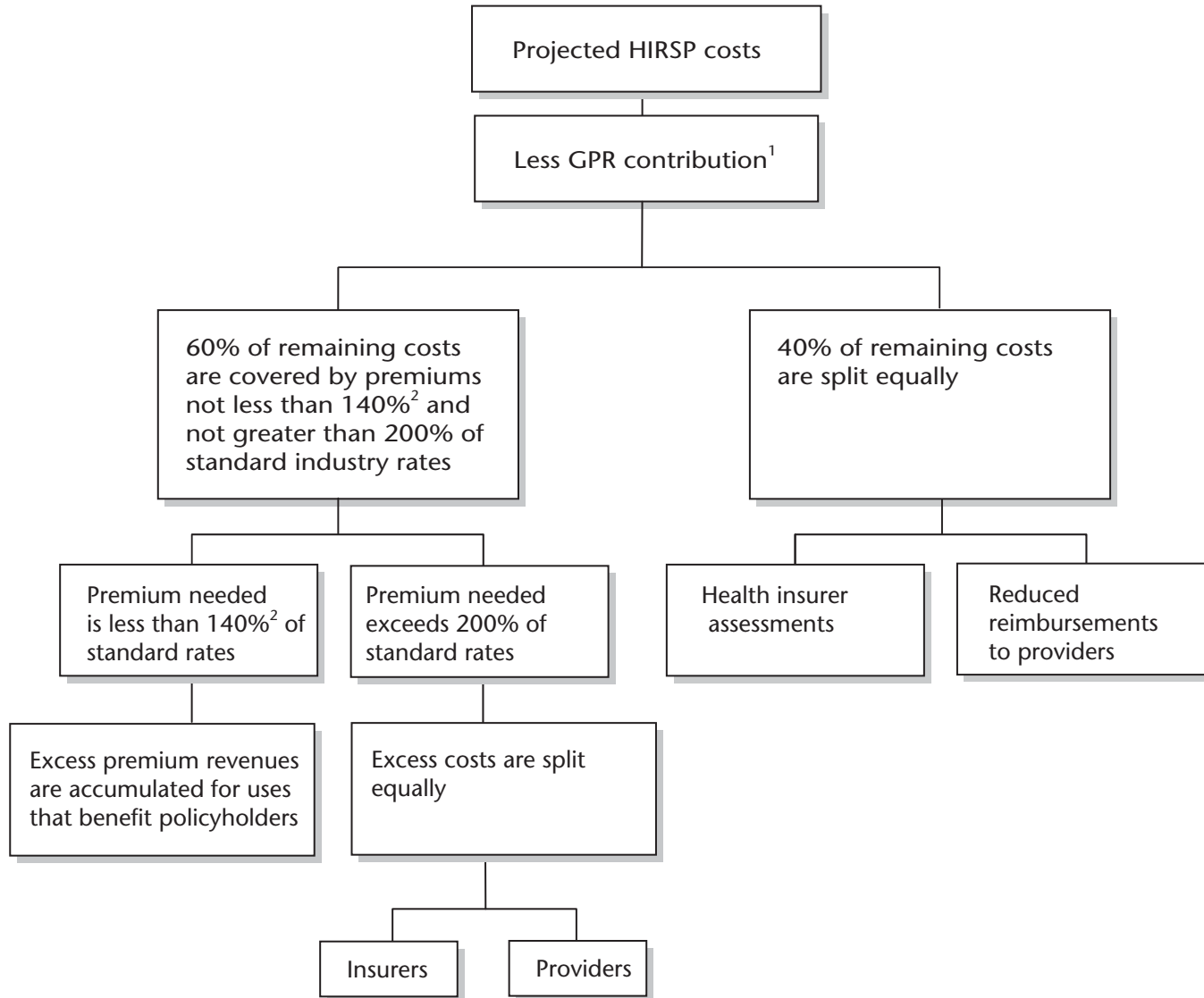
Statutes prescribe a funding formula for HIRSP that requires policyholders, private health insurers, and health care providers to share in estimated operating and administrative costs remaining after the GPR contribution has been deducted. Policyholder premiums are expected to fund 60 percent of the remaining estimated operating and administrative costs.

Prior to July 30, 2002, premium rates were statutorily required to be at least 150 percent, but not in excess of 200 percent, of standard risk rates (that is, the rates that private insurers would charge for individual insurance policies that provide substantially the same coverage and deductibles available under HIRSP). Private health insurers doing business in Wisconsin and health care providers providing medical services to HIRSP policyholders are required to share equally in the remaining 40 percent of operating and administrative costs.

In addition, insurers and health care providers share equally in the excess costs not funded by policyholder premiums when the premium rates needed to fund 60 percent of costs exceed 200 percent of standard risk rates. If premiums of less than 150 percent of the standard rates were required to fund 60 percent of HIRSP's estimated costs after the GPR contribution has been deducted, the premium rate would nonetheless be set at 150 percent of the standard rates in accordance with statutes, and excess funds would be set aside to reduce rates in years that would otherwise require higher premiums, or for other purposes that benefit policyholders.

To provide additional flexibility in establishing premium rates, 2001 Wisconsin Act 109 lowered the minimum premium level from 150 percent to 140 percent of the standard risk rate, effective July 30, 2002. Also, under 2003 Wisconsin Act 33, all GPR support for HIRSP is eliminated. Beginning in FY 2003-04, the other funding parties will be required to pay for costs previously funded through GPR. A diagram of HIRSP's funding provisions as of June 30, 2003, follows.

Payment of Operating and Administrative Costs
(As of June 30, 2003)



¹All GPR support was eliminated beginning in FY 2003-04.

²150% before July 30, 2002.



State of Wisconsin
Department of Health and Family Services

Jim Doyle, Governor
Helene Nelson, Secretary

April 1, 2004

Janice Mueller, State Auditor
Legislative Audit Bureau
22 W. Mifflin Street, Suite 500
Madison, WI 53704

Dear Ms. Mueller:

This letter is in response to the Legislative Audit Bureau's (LAB) audit report of the Health Insurance Risk Sharing Plan's (HIRSP) State Fiscal Year (SFY) 2003 Financial Statements. On behalf of the Department of Health and Family Services (DHFS) and the HIRSP Board of Governors, I would like to thank you and the LAB audit staff for working with DHFS and the HIRSP plan administrator to conduct the audit.

We agree with the audit report. The audit report acknowledges that increasing enrollment presents continuing challenges to the management and funding of HIRSP. As cited in the audit, HIRSP experienced a 16.9 percent increase in enrollment during SFY 2003, although the rate of increase in enrollment appears to have tapered off in recent months.

Despite the challenges associated with growing enrollment, HIRSP's financial position continued to improve in SFY 2003. The DHFS, together with the HIRSP Board, remain diligent in our administration of HIRSP. As a result:

HIRSP's accounting deficit has decreased by another \$5.1 million from SFY 2002 to SFY 2003 and, as of June 30, 2003, is less than \$1 million. Since June 30, 2000, we have reduced the accounting deficit by more than \$8 million.

Net assets increased by approximately \$12.5 million in SFY 2003.

Total administrative costs, as a percent of total program costs, actually declined in SFY 2003 and account for only 4.9 percent of program costs (5.3 percent in SFY 2002).

Average claims costs per policyholder increased by 10.7 percent in SFY 2003, which is approximately 3 percent lower than medical cost increases experienced for health care for commercial plans or for state employees.

The audit highlights a couple of technical issues that the Department and Board are aware of and in the process of remedying. The report outlines a "technical statutory issue" regarding the manner which the state statutes treat policyholder deductible subsidies in the HIRSP funding formula. At the Board's direction, Department staff will submit 2005-07 Biennial Budget statutory language request that would resolve this technical issue.

Janice Mueller

April 1, 2004

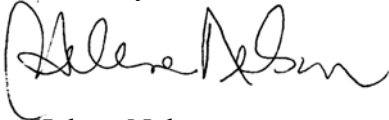
Page 2

Furthermore, the report identifies the need for the Department to increase its oversight of pharmacy claims through independent audits of the pharmacy benefits management company's controls. As the report mentions, the Department is currently procuring for a new HIRSP administrative services vendor and has included this independent audit requirement in its request for proposal for a new plan administrator.

On behalf of the DHFS and the HIRSP Board, we are very proud of our accomplishments. HIRSP is more stable and in a better financial position than the prior year, even with the challenges associated with a growing health plan.

We appreciate the time and effort extended by the LAB staff to perform this audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Helene Nelson". The signature is written in a cursive style with a large initial "H" and "N".

Helene Nelson
Secretary