03-12
November 2003

An Audit

Health Insurance Risk-Sharing Plan

Department of Health and Family Services

LEGISLATIVE AUDIT BUREAU

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State Auditor - Janice Mueller

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State of Wisconsin \ LEGISLATIVE AUDIT BUREAU

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November 19, 2003

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) 2001-02. HIRSP provides medical and prescription drug insurance for approximately 17,000 policyholders who are unable to obtain coverage in the private market. We have provided an unqualified opinion on HIRSP's financial statements and have followed up on issues raised in prior audits.

One of these issues relates to HIRSP's financial stability. Actions taken to implement an accrual-based funding approach in response to prior audit recommendations have helped to reduce the accounting deficit from $8.2 million as of June 30, 2001, to $5.5 million as of June 30, 2002. Further, based on preliminary unaudited financial statements, the deficit was less than $1.0 million as of June 30, 2003. However, the elimination of general-purpose revenue (GPR) support beginning in FY 2003-04, together with increasing enrollment and claims costs, presents continuing challenges to the management and funding of HIRSP. Enrollment increased 16.9 percent, and claims costs increased 27.8 percent, during FY 2002-03. The loss of GPR, which totaled $10.2 million in FY 2002-03, is now covered by policyholders, insurers, and health care providers.

DHFS has taken steps to address prior concerns with its loss estimates and administrative billings. Current procedures call for increased review of actuarial loss estimates. DHFS also has streamlined its fee structure for the services of the HIRSP administrator, which has simplified billing and monitoring of administrative invoices.

Finally, DHFS has improved the system for pharmacy claims by using a pharmacy benefit management company beginning in FY 2001-02. However, oversight of pharmacy claims, which totaled $23.1 million in FY 2001-02 and $32.4 million in FY 2002-03, could be further improved through independent reviews of the company's controls.

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,

Janice Mueller

Janice Mueller
State Auditor

JM/DA/ss

Report Highlights ▪

HIRSP's financial position improved during FY 2001-02.

Policyholder enrollment and claims costs continue to increase.

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

Oversight of pharmacy claims could be improved.

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 regulations and to provide health insurance to people who lose employer-sponsored group health insurance and meet other specified criteria.

HIRSP is 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 June 30, 2003, 17,017 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, and it requires policyholders to 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 a 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, 2002 and 2001.

Financial Status of the Plan

Since we began auditing HIRSP's financial statements in 1998, we recommended that HIRSP be funded on an accrual basis, rather than the cash-based approach used at the time. A cash-based funding approach takes into account estimated cash disbursements. An accrual basis takes into account the full costs associated with events that occur during a plan year, including actuarial cost estimates for claims incurred that may not be filed until after the plan year.

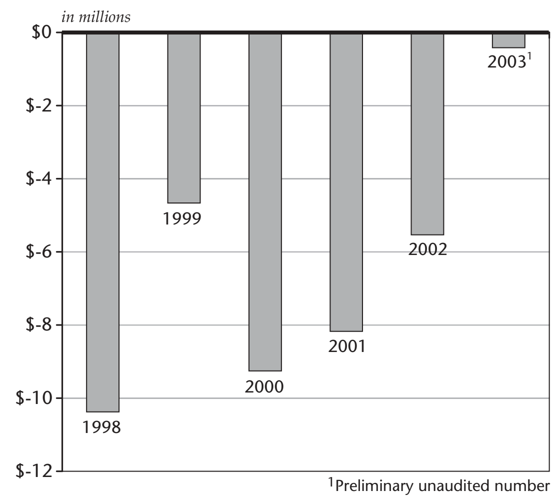
HIRSP previously used a cash-based funding approach that contributed to an accounting deficit because it did not factor in all claims liabilities. As a result, HIRSP's accounting deficit of $8.2 million as of June 30, 2001, represented the estimated additional cash HIRSP would eventually need to make payment on its liabilities.

DHFS and HIRSP's Board of Governors decided to implement an accrual-based approach to funding HIRSP beginning with fiscal year (FY) 2001-02. The change to an accrual-based approach required funding to eliminate the accounting deficit that had accumulated under the cash-based approach, in addition to funding HIRSP's newly incurred costs on an accrual basis.

As a result of increasing program costs and the funding change, policyholder premiums and insurer assessments increased significantly during FY 2001-02. Total premiums increased 29.3 percent, while insurer assessments almost doubled, from $9.9 million in FY 2000-01 to $19.6 million during FY 2001-02. The increased revenues that resulted from increases in premiums and insurer assessments contributed to a $2.7 million reduction in HIRSP's accounting deficit, which was $5.5 million as of June 30, 2002. Based on preliminary unaudited financial statements, the deficit was less than $1.0 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 Deficit As of June 30



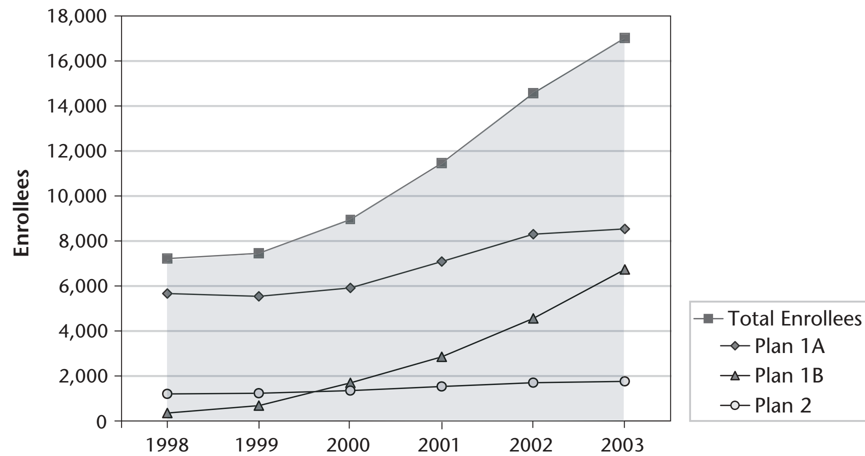
Increasing Enrollment and Claims Costs

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, and continues to increase.

Although growth has begun to level off for two of the plans in recent years, enrollment in plan 1B has continued to increase steadily. While a variety of factors may have contributed to interest in plan 1B, its lower premiums in comparison to plan 1A have made it popular. Enrollment trends are shown in Figure 2.

Figure 2

HIRSP Enrollment by Plan
As of June 30



Like enrollment levels, HIRSP's claims costs are increasing. Net of health care providers' discounts, the increase was 48.7 percent, or $17.7 million, in FY 2000-01, and 24.1 percent, or $13.1 million, in FY 2001-02. Based on unaudited data, claims costs increased 27.8 percent, or $18.7 million, in FY 2002-03. A large portion of these increases can be explained by the enrollment increases, although they are also affected by increases in medical costs similar to those experienced by others in the health insurance industry. For example, the average cost per HIRSP policyholder, net of provider discounts, increased 12.5 percent, from $4,824 in FY 2000-01 to $5,428 in FY 2001-02.

Table 1

Claims Costs

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[1]	85,849,897	27.8

[1] Preliminary unaudited number

Enrollment and cost trends are also increasing required funding levels. If these trends continue, pressures likely will increase to control the costs borne by HIRSP's funding parties and to evaluate the fairness and effectiveness of the current funding structure.

Budget Provisions

Beginning in FY 1997-98, the Legislature provided GPR funding to offset program costs, in addition to GPR funding for premium and deductible subsidies available for low-income policyholders that had been in place for several years. GPR support for HIRSP during the 2001-03 biennium totaled $21.0 million. Under 2003 Wisconsin Act 33, the 2003-05 Biennial Budget Act, all GPR support for HIRSP is eliminated, effective FY 2003-04. The other funding parties are now required to pay for costs previously funded through GPR.

Act 33 also eliminated the requirement that the HIRSP plan administrator be the Medicaid fiscal agent and instead authorizes DHFS to select the HIRSP plan administrator through a competitive bidding process. HIRSP's Medicaid fiscal agent has been the administrator since 1998. DHFS is currently developing a request for vendor proposals, with the intent of selecting and contracting with a vendor to administer HIRSP beginning in FY 2004-05.

Fiscal Management Issues

DHFS has improved the system for pharmacy claims, which were $23.1 million during FY 2001-02 and $32.4 million during FY 2002-03, by using a pharmacy benefit management company beginning in FY 2001-02. However, oversight of pharmacy claims could be further improved with periodic reviews of the controls put in place by the pharmacy benefit management company. Claims processing organizations and other entities that provide similar services to several organizations often obtain special independent external reviews of their controls to fulfill the need of user organizations and their 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.

Although HIRSP's plan administrator regularly obtains a SAS 70 audit, the pharmacy benefit management company does not. In response to recommendations we made orally during this audit, DHFS is considering pursuing a SAS 70 audit or alternative steps to provide independent reviews of controls over pharmacy claims.

DHFS has also taken steps to address two areas of concern identified during our FY 2000-01 audit. First, we found that inadequate procedures and communication regarding claims data and the actuarial process led to an estimate of actuarial loss liabilities that was materially in error and required an adjustment to HIRSP's financial statements. In response, procedures were revised, and the Board of Governor's Financial Oversight Committee took responsibility to review the loss liability estimates. The estimates for the FY 2001-02 financial statements were materially correct. The second area of concern in our prior audit was problems with plan administrator fees, which totaled $3.2 million in FY 2001-02. In response, DHFS implemented a streamlined fee structure to simplify the billing process and make it easier to monitor administrative invoices. We noted no problems during our current audit.

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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 the program rule-making authority and establishes the annual budget. Although DHFS currently contracts with the State's fiscal agent for Medicaid to administer HIRSP, 2003 Wisconsin Act 33 eliminated the requirements that the plan administrator be the Medicaid fiscal agent. In the future, DHFS will select the HIRSP plan administrator through a competitive bidding process.

At the request of DHFS, we completed a financial audit of HIRSP for FY 2001-02. As necessary parts of the financial audit, we reviewed HIRSP's control procedures, assessed the fair presentation of the FY 2001-02 financial statements, and reviewed compliance with statutory provisions. We also reviewed DHFS's progress in addressing past concerns with estimates of actuarial loss liabilities and monitoring of administrative billings.

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.

- Plan 1B is an alternative plan that was introduced in 1998 to comply with the federal Health Insurance Portability and Accountability Act's 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.

- 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.

Effective January 1, 1998, 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 services and items to share equally with insurers in program costs that were not covered by premiums and GPR. 2001 Wisconsin Act 16 excluded pharmacies from the funding requirement for providers, effective September 1, 2001.

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

In addition, the Legislature retained 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 share equally in the subsidy program costs that are not covered by GPR, which totaled $1.8 million during FY 2001-02. In the 2001-03 biennium, GPR support for HIRSP totaled $21.0 million. However, as noted, all GPR support for HIRSP was eliminated in the 2003-05 Biennial Budget Act.

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, which are required to fund 60 percent of the remaining estimated operating and administrative costs, are established based on a complex formula, enumerated in the appendix, that provides minimum and maximum premium levels based on standard industry rates. 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.

Premium rates for each of HIRSP's three plans differ on the basis of policyholders' gender, age, and geographic location. 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. FY 2001-02 is an exception; premium rates for the primary plan were set at 161.9 percent of standard rates that year. Premium rate increases since 1998 are shown in Table 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

For both plan 1A and plan 1B, rate increases 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. Plan 2, which is available for certain Medicare participants, typically experienced larger rate increases than the other two plans, 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 consistent for all plans and to reduce the extent to which plans 1A and 1B are subsidizing plan 2.

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 2001-02, 26 percent of HIRSP policyholders received subsidies, at a cost of $2.6 million.

Policyholders enrolled in plan 1A or plan 2 with annual household incomes below $25,000 are eligible for premium subsidies. Policyholders enrolled in plan 1A with 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 2001-02, 26 percent of HIRSP policyholders received subsidies, at a cost of $2.6 million.

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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 as of and for the years ended June 30, 2002 and 2001. 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 the Health Insurance Risk-Sharing Plan 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 the Health Insurance Risk-Sharing Plan as of June 30, 2002 and 2001, 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, the Health Insurance Risk-Sharing Plan 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 the Health Insurance Risk-Sharing Plan. The supplementary information included as Management's Discussion and Analysis on pages 17 through 22 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 November 10, 2003, on our consideration of the Health Insurance Risk-Sharing Plan'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.

LEGISLATIVE AUDIT BUREAU

November 10, 2003 by Diann Allsen

Diann Allsen
Audit Director

Management's Discussion and Analysis ▪

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

This section of the Wisconsin Health Insurance Risk-Sharing Plan (HIRSP) annual financial report presents management's discussion and analysis of the financial performance of HIRSP during the fiscal year ended June 30, 2002. 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. As a result, the format of the current year's financial statements differs from the format used in prior financial statements. The FY 2000-01 information was also reformatted to conform with the new financial reporting model; there was no effect on total net assets or the change in net assets.

In this discussion and analysis, we will review the reasons for the changes in financial activity between FY 2000-01 and FY 2001-02. Therefore, for the comparisons presented in Table A, we have reformatted the FY 2000-01 financial statements to conform to the current year's presentation.

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 Fund 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 2001-02, 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 premium and deductible subsidies for low-income policyholders. Prior to FY 1997 98, only GPR funding for premium and deductible subsidies was available. 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 service. Section 149.143, Wis. Stats., prescribes a funding formula for HIRSP that requires policyholders, private health insurers, and health care providers 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 per 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 the deduction of amounts available from premiums and any GPR appropriated under s. 20.435(4)(af), Wis. Stats.;
- premium and deductible 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

Net assets may serve over time as a useful indicator of the financial position of HIRSP. In the case of HIRSP, liabilities exceeded assets by $2,965,523, at the close of the fiscal year ending June 30, 2002, an improvement of $3,079,906 over June 30, 2001, in total net assets.

Table A

Condensed Financial Information

Fiscal Year Ended:	June 30, 2002	June 30, 2001	Percentage Change
Total Assets	$27,540,481	$20,326,448	35.5%
Total Liabilities	30,506,004	26,371,877	15.7
Net Assets:			
Restricted	2,568,732	2,128,863	20.7
Unrestricted	(5,534,255)	(8,174,292)	32.3
Total Net Assets:	$(2,965,523)	$(6,045,429)	50.9
Operating Revenues	$62,995,554	$43,439,043	45.0
Operating Expenses	(71,069,074)	(58,502,717)	21.5
Nonoperating Revenues (Expenses)	11,153,426	11,065,684	0.8
Change in Net Assets	$ 3,079,906	$(3,997,990)	177.0

The largest portion of the Plan's net assets, 90.6 percent, is in the form of cash. 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 liability of HIRSP is the unpaid loss liability. Unpaid loss liabilities represent the accumulation of losses, net of discounts from providers, that was 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 $3,079,906 during FY 2001-02. 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 2001-02.

Financial Highlights

- Plan enrollment as of June 30, 2002 was 14,563, an increase of 27.1 percent over June 30, 2001 enrollment of 11,460. 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 16.0 percent.

- Plan operations are conducted by DHFS staff, as well as a third-party contract administrator.
  - Total administrative costs for FY 2001-02 were $3,784,699, down 11.8 percent from $4,291,490 for FY 2000-01.
  - Total administrative costs were 5.3 percent of program costs for FY 2001-02, a decrease from 7.3 percent of program costs for FY 2000-01. This is primarily attributed to the plan administrator rescinding in January 2002 administrative invoices totaling $447,081 that had been accrued as of June 30, 2001.

- HIRSP's change in net assets increased.
  - The change in net assets was $3,079,906, an improvement of over $7.0 million from the ($3,997,990) change in FY 2000-01.
  - Investment income declined from $882,961 in FY 2000-01 to $372,626 in FY 2001-02, due to declining interest rates.

- Net assets are split between restricted and unrestricted.
  - Restricted net assets for excess policyholder premiums increased from $2,128,863 to $2,568,732. The restricted net assets are statutorily required under s. 149.143(2m), 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 ($8,174,292) to ($5,534,255). 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 W Wilson Street
POB 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, 2002 and 2001

	June 30, 2002	Restated June 30, 2001
ASSETS		
Cash and Cash Equivalents (Note 2)	$ 24,958,974	$ 18,639,677
Assessments Receivable	278,103	35,439
Other Receivables	2,244,142	1,592,124
Prepaid Items	59,262	59,208
TOTAL ASSETS	**$ 27,540,481**	**$ 20,326,448**
LIABILITIES AND NET ASSETS		
Liabilities:		
Unpaid loss liabilities (Note 3)	$ 14,674,153	$ 17,168,158
Unpaid loss adjustment expenses (Note 3)	621,900	621,900
Unearned premiums	10,470,731	7,418,496
Liability for premium overpayments (Note 4)	471,488	0
Accounts payable and other accrued liabilities	4,267,732	1,163,323
Total Liabilities	**30,506,004**	**26,371,877**
Net Assets:		
Restricted for excess policyholder premiums (Note 5)	2,568,732	2,128,863
Unrestricted (Note 11)	(5,534,255)	(8,174,292)
Total Net Assets	**(2,965,523)**	**(6,045,429)**
TOTAL LIABILITIES AND NET ASSETS	**$ 27,540,481**	**$ 20,326,448**

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, 2002 and 2001

	For the Year Ended June 30, 2002	Restated for the Year Ended June 30, 2001
OPERATING REVENUES		
Premiums	$ 43,375,232	$ 33,540,723
Insurers' Assessments (Note 6)	19,620,322	9,898,320
Total Operating Revenues	**62,995,554**	**43,439,043**
OPERATING EXPENSES		
Losses:		
Losses paid or approved for payment	70,627,947	49,945,868
Increase (decrease) in unpaid losses	(3,447,169)	4,174,639
Total Losses	**67,180,778**	**54,120,507**
General and Administrative Expenses (Note 9)	3,784,699	4,291,490
Referral Fees	103,597	90,720
Total Operating Expenses	**71,069,074**	**58,502,717**
OPERATING LOSS	**(8,073,520)**	**(15,063,674)**
NONOPERATING REVENUES AND EXPENSES		
Revenue from the State of Wisconsin	10,000,000	11,900,000
State Premium and Deductible Subsidies (Note 8)	780,800	780,800
Investment Income	372,626	882,961
Distribution to Policyholders (Note 13)	0	(2,498,077)
Total Nonoperating Income	**11,153,426**	**11,065,684**
CHANGE IN NET ASSETS	**3,079,906**	**(3,997,990)**
NET ASSETS		
Total Net Assets—Beginning of the Year	(6,045,429)	(2,047,439)
Total Net Assets—End of the Year	**$ (2,965,523)**	**$ (6,045,429)**

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2002 and 2001

	For the Year Ended June 30, 2002	Restated for the Year Ended June 30, 2001
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received for Premiums	$ 46,728,384	$ 34,209,643
Cash Received for Assessments	19,377,658	9,862,882
Cash Payments for Losses	(66,910,922)	(49,823,506)
Cash Payments for Other Expenses	(4,029,249)	(3,749,207)
Cash Distribution to Policyholders	0	(2,498,077)
Net Cash Used by Operating Activities	**(4,834,129)**	**(11,998,265)**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Cash Received from State of Wisconsin	10,780,800	12,680,800
Net Cash Provided by Noncapital Financing Activities	**10,780,800**	**12,680,800**
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Income	372,626	866,682
Net Cash Provided by Investing Activities	**372,626**	**866,682**
NET INCREASE IN CASH AND CASH EQUIVALENTS	**6,319,297**	**1,549,217**
Cash and Cash Equivalents, Beginning of Year	18,639,677	17,090,460
Cash and Cash Equivalents, End of Year	$ 24,958,974	$ 18,639,677
RECONCILIATION OF NET OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net Operating Loss	$ (8,073,520)	$ (15,063,674)
Adjustments to Reconcile Net Operating Loss to Net Cash Provided by Operating Activities:		
Cash distribution to policyholders	0	(2,498,077)
Changes in assets and liabilities:		
Decrease (increase) in receivables	2,311,484	(1,187,070)
Decrease (increase) in prepaids	(50)	25,275
Increase (decrease) in liability for premium overpayments	471,488	0
Increase (decrease) in accounts payable	(101,760)	470,723
Increase (decrease) in unearned premiums	3,052,235	1,878,558
Increase (decrease) in loss liabilities	(2,494,006)	4,376,000
Total Adjustments	3,239,391	3,065,409
Net Cash Used by Operating Activities	**$ (4,834,129)**	**$ (11,998,265)**

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. Plans 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 plan 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 the deduction of amounts available from premiums and the GPR appropriated under s. 20.435(4)(af), Wis. Stats.;
- premium and deductible subsidy costs in excess of 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 liability as described in Note 1E and the provider contribution as described in Note 10. 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 No. 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 No. 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 $897,099 at June 30, 2002, and $880,820 at June 30, 2001. The bank balance was $1,516,084 at June 30, 2002, and $1,895,592 at June 30, 2001. 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, 2002, and June 30, 2001, $400,000 was insured and classified in risk category 1; $1,116,084 at June 30, 2002, and $1,495,592 at June 30, 2001, 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 $23,679,096 as of June 30, 2002, and $17,656,548 as of June 30, 2001.

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 No. 3. The State Investment Fund is not registered with the Securities and Exchange Commission.

3. 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 2001-02 and 2000-01 (in thousands):

	FY 2001-02	FY 2000-01
Balance, Beginning of Year	$17,790	$13,414
Incurred Claims:		
Provision for insured events of the current fiscal year	75,553	57,688
Changes in provision for insured events of prior fiscal years	(7,035)	(3,010)
Total Incurred	68,518	54,678
Payments:		
Claims attributable to insured events of the fiscal year	61,161	40,212
Claims attributable to insured events of prior fiscal years	9,851	10,090
Total Paid	71,012	50,302
Balance, End of Year	$15,296	$17,790

4. 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 8 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 return $471,488 to currently active policyholders. As a result, an estimated 2,901 active policyholders who were subsidized during FY 2001-02 will receive checks for $162.53. The checks are expected to be mailed in early December 2003.

5. 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 premium 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.

6. INSURER ASSESSMENTS

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.

7. 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 8 further discusses the pharmacy subsidies provided in FY 2001-02 and FY 2000-01.

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

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

8. PREMIUM, DEDUCTIBLE, AND PHARMACY SUBSIDIES

HIRSP provides a premium and deductible subsidy program to reduce premium and deductible levels that would otherwise be paid by 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.

HIRSP premiums 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 2001-02, premium rates for the primary plan were set at 161.9 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.

Annual Household Income at Least	Annual Household Income but Less Than	Amount of Premium as Percentage of Standard Risk Rates	Reduction in Deductible
$ 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-six percent of HIRSP policyholders received premium, deductible, and pharmacy subsidies costing $2,553,303 in FY 2001-02 and $2,701,622 in FY 2000-01. The following table summarizes the amounts provided for each subsidy type during these years.

Subsidy Type	FY 2001-02	FY 2000-01
Premium	$1,918,393	$2,182,758
Deductible	624,910	518,864
Pharmacy[1]	10,060	0
Total	$2,553,363	$2,701,622

[1]For the six months ending June 30, 2002. There was no pharmacy subsidy program in FY 2000-01.

A total of $780,800 of GPR was appropriated and spent for premium and deductible subsidies in FY 2001-02 and FY 2000-01. No GPR money was appropriated for pharmacy subsidies in either year. Costs in excess of GPR appropriated for this purpose were shared equally by health insurers and health care providers, with each contributing $886,282 in FY 2001-02 and $960,411 in FY 2000-01. Pharmacies are exempt from contributing toward these costs.

9. General and Administrative Expenses

General and administrative expenses include the following:

	FY 2001-02	FY 2000-01
Plan Administrator Fees	$ 3,170,135	$3,735,929
State Administrative Costs	358,460	379,332
Postage	180,291	138,410
Other Expenses	75,813	37,819
Total	$3,784,699	$4,291,490

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.

10. HEALTH CARE PROVIDERS' CONTRIBUTIONS

Statutes prescribe that health care providers except pharmacies contribute to their share of HIRSP costs. Provider contributions are obtained by reducing the amount reimbursed to providers for billed services. The provider contribution is not reported as a 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 $15,757,717 for FY 2001-02 and $11,616,786 for FY 2000-01. 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.

11. NEGATIVE NET ASSETS

Negative 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. In contrast, financial reporting is based 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. In April 2001, the Board of Governors approved to fund HIRSP on an accrual basis beginning in FY 2001-02.

12. SUBSEQUENT EVENT

In May 2000, it was determined that significant overpayments had been made on prescription drug claims. The HIRSP Board of Governors approved a plan to recover the overpayments that had occurred from July 1998 through January 2001. In December 2001, DHFS sent letters to approximately

900 pharmacies requesting repayment of $5.2 million. Subsequently, with the enactment of 2001 Wisconsin Act 109, the Legislature prohibited DHFS from recovering the overpayments and required it to return any recoveries already received before the Act's effective date of July 30, 2002, and further exempted pharmacies from contributing to the costs of HIRSP. All overpayment recoveries previously collected, which totaled $391,359, were returned in September 2002.

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.

13. POLICYHOLDER DISTRIBUTION

The HIRSP Board of Governors approved a distribution to policyholders under s. 149.143(2m)(b)2, Wis. Stats. DHFS distributed checks to 6,605 policyholders on January 18, 2001, that totaled $2,498,077. This distribution reduced the net assets restricted for premiums received in excess of the policyholders' share of plan costs for FY 2000-01.

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 included reclassifying revenues not related to HIRSP's primary purpose from operating to non-operating, recording net assets as restricted or unrestricted, and adding management's discussion and analysis of HIRSP's financial operations. The FY 2000-01 information was also reformatted to conform with the new financial reporting model; there was no effect on total net assets or the change in net assets.

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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, 2002, and June 30, 2001, and have issued our report thereon dated November 10, 2003. 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 the Health Insurance Risk-Sharing Plan'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 a noncompliance issue that is required to be reported under *Government Auditing Standards.* As discussed in last year's audit report, 02-17, and in Note 12 of the financial statements, a suspension of system controls that ensured proper payment of drug claims resulted in payment of drug claims in excess of Medicaid-allowable rates required by statute during fiscal years 2000-01 and 1999-2000. The Department of Health and Family Services (DHFS) reinstated system controls on

January 29, 2001, and implemented an on-line processing system for pharmacy claims to improve the claims process. DHFS also initiated steps to recover the overpayments, but the Legislature subsequently directed it to discontinue its recovery effort and return any recoveries already received.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered 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, during our audit, we note that 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 fulfil 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 pharmacy 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 pharmacy 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 verbally during the audit, DHFS is considering pursuing a SAS 70 audit or alternative steps to provide independent reviews of controls over pharmacy claims.

This independent auditor's report is intended for the information and use of DHFS's management and the Wisconsin Legislature. This independent auditors 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.

LEGISLATIVE AUDIT BUREAU

November 10, 2003 by Diann Allsen

Diann Allsen
Audit Director

Appendix

Payment of HIRSP Operating and Administrative Costs

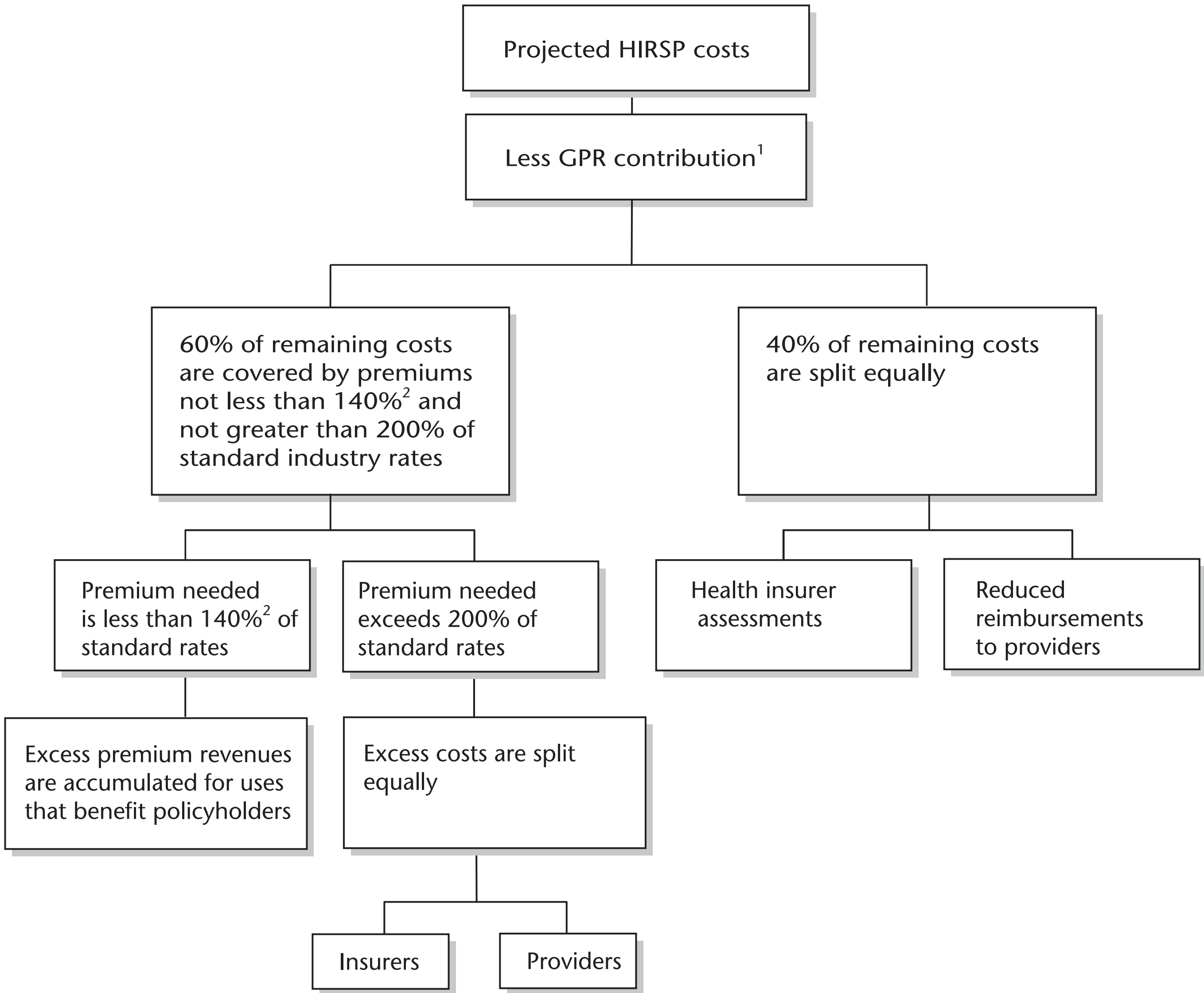
Statutes prescribe a funding formula for HIRSP that requires policyholders, private health insurers, and health care providers to share in estimated operating and administrative costs remaining after the GPR contribution has been deducted. Policyholder premiums are expected to fund 60 percent of the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



[1] All GPR support was eliminated beginning in FY 2003-04.
[2] 150% before July 30, 2002.

State of Wisconsin
Department of Health and Family Services

Jim Doyle, Governor
Helene Nelson, Secretary

November 13, 2003

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

Dear Ms. Mueller:

This letter is in response to the audit performed by the Legislative Audit Bureau (LAB) of the SFY 2002 financial statements of the Health Insurance Risk Sharing Plan (HIRSP).

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. As the audit report points out, HIRSP experienced a 27 percent increase in enrollment during the audit period (SFY 2001-02) and an additional 16.9 percent increase during SFY 2002-03. These increases are consistent with increases experienced in Medicaid and BadgerCare and we believe that the downturn in the economy is likely to be a factor. In addition, in reviewing CY 2002 data, we found that:

- Sixty-five percent (65%) of approved HIRSP applications were submitted by individuals who, because of their medical conditions, were rejected for coverage in the commercial market or had received a notice of a benefit reduction or significant premium increase from their prior commercial health insurance carrier.

- Thirty-one and half percent (31.5%) of approved HIRSP applications were submitted by individuals who had lost their employer-sponsored group health insurance. Reasons for losing their health insurance may include former employers going out of business or discontinuing health insurance as a benefit, or the individual found different employment through a company that does not offer insurance.

The audit report acknowledges that the increasing enrollment presents continuing challenges to the management and funding of HIRSP. We are especially proud of the LAB's recognition that HIRSP's financial position continued to improve in SFY 2001-02 and in SFY 2002-03, even with the significant increases in enrollment. The DHFS, together with the HIRSP Board, have been, and continue to be, diligent in our administration of HIRSP. As a result:

- Administrative costs actually declined in SFY 2001-02 and account for only 5.3 percent of program costs.

- Net assets increased by $3 million in SFY 2001-02 and preliminary unaudited financial statements for SFY 2002-03 suggest continued improvement.

- Average costs per policyholder increased by only 12.5 percent in SFY 2001-02. This increase is much lower than medical cost increases experienced for health care in the private sector or for state employees during the same period.

- HIRSP converted from its previous cash-based funding approach to a more fiscally sound accrual-based funding approach.

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

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

Sincerely,

Helene Nelson
Secretary