AN AUDIT

Health Insurance Risk-Sharing Plan

Department of Health and Family Services

02-17

November 2002

2001-2002 Joint Legislative Audit Committee Members

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November 8, 2002

Senator Gary R. George and
Representative Joseph K. Leibham, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator George and Representative Leibham:

At the request of the Department of Health and Family Services, we have completed a financial audit of the Health Insurance Risk-Sharing Plan (HIRSP) for fiscal year (FY) 2000-01. HIRSP provides medical insurance for approximately 15,300 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. Recent actions taken to implement an accrual-based funding approach in response to our prior audit recommendations will help to address an accounting deficit of $8.2 million. However, increasing enrollment and claims costs will present continuing challenges to the future management and funding of HIRSP. Enrollment increased 27.1 percent and claims costs increased 24.2 percent during FY 2001-02.

Second, in earlier audits we reported on the overpayment of prescription drug claims for prescriptions dispensed from July 1998 through January 2001. The Department has taken several steps to prevent additional overpayments and to improve its pharmacy claims process, including implementing an on-line processing system and separating drug coinsurance provisions. The Department also took steps to recover the $5.2 million of overpayments we identified. However, as part of the 2001-03 Budget Reform Act, the Legislature directed the Department to discontinue its recovery efforts. As a result, the overpayments remain a cost that is shared by policyholders, insurers, and other health care providers.

Concerns identified during the current audit suggest that the Department needs to remain diligent in improving its financial management. Inadequate procedures and communication regarding claims data and the actuarial process led to an estimate of actuarial loss liabilities that was materially in error in HIRSP's financial statements. Further, ongoing billing problems suggest that the Department needs to increase its monitoring of administrative billings by the plan administrator, EDS.

We appreciate the courtesy and cooperation extended to us by the Department and the plan administrator for HIRSP. A response from the Department is Appendix 2.

Respectfully submitted,

Janice Mueller
State Auditor

JM/DA/ss

Summary

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. As of September 30, 2002, 15,267 policyholders were enrolled in HIRSP, which represents the highest number in the plan's history. General purpose revenue (GPR) support for HIRSP totaled $23.4 million in the 1999-2001 biennium.

At the request of the Department of Health and Family Services, we performed a financial audit of HIRSP for fiscal year (FY) 2000-01. We have provided an unqualified opinion on HIRSP's FY 2000-01 financial statements and followed up on issues related to program funding and pharmacy claims that were discussed in prior audits.

Since we began auditing HIRSP's financial statements in 1998, we have recommended that HIRSP be funded on an accrual basis rather than the cash-based approach used at the time. HIRSP's cash-based funding approach has contributed to an accounting deficit, which was $8.2 million as of June 30, 2001. That amount represents the estimated additional cash HIRSP would need to pay its liabilities as of June 30, 2001. In April 2001, the Department and HIRSP's Board of Governors decided to implement an accrual-based approach to funding HIRSP, beginning in FY 2001-02.

Increasing enrollment and claims costs will present continuing challenges to the future management and funding of HIRSP. Enrollment increased 28.1 percent during FY 2000-01 and 27.1 percent during FY 2001-02, and it is projected by HIRSP's actuary to increase another 19.9 percent in FY 2002-03. Claims costs increased 48.9 percent during FY 2000-01 and 24.2 percent during FY 2001-02. The reasons for the increasing enrollment are not entirely clear but may, in part, include the discontinuance of health insurance coverage by some insurance companies and small employers. If these trends continue, pressures likely will increase to control the costs borne by HIRSP's funding parties and to evaluate the effectiveness of the current funding structure.

During our FY 1998-99 audit, we found that, in response to complaints from policyholders and pharmacies regarding the Medicaid-based claims system, the Department had suspended controls that ensured HIRSP policyholders and pharmacies were reimbursed for prescription drugs at HIRSP-allowed rates. As a result, HIRSP overpaid drug claims by an estimated $5.2 million for prescriptions dispensed from July 1998 through January 2001. Since being notified of the problem, the Department has taken several steps to improve its pharmacy claims process, including resuming controls, implementing an on-line processing system, and establishing separate drug coinsurance provisions. The Department also took steps to recover the overpayments, including sending recovery notices to the pharmacies. However, as part of 2001 Wisconsin Act 109, the 2001-03 Budget Reform Act, the Legislature directed the

Department to discontinue its recovery efforts and to return overpayments already collected. As a result, the overpayments remain a cost of HIRSP that is shared by policyholders, insurers, and other health care providers.

While the Department has made good progress in addressing concerns identified in past audits, additional concerns identified during the current audit suggest that the Department needs to remain diligent in its financial management of HIRSP. We believe the Department needs to establish a more formal process for establishing and reporting actuarial estimates of unpaid loss liabilities. 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 of $1.8 million to HIRSP's financial statements.

Finally, ongoing billing problems suggest that the Department needs to increase its monitoring of plan administrator fees, which were $3.8 million in FY 2000-01. Several billing problems occurred over the last four fiscal years, which resulted in financial reporting errors in the financial statements. The Department is currently working with the plan administrator to simplify its administrative fees by establishing a flat monthly rate for the routine administrative services that the plan administrator provides. The flat monthly rate should improve the Department's ability to anticipate and monitor routine administrative billings, although the Department will need to remain diligent in anticipating and monitoring variable costs, such as for special projects requested of the plan administrator, and in ensuring administrative costs are properly reflected in its financial records.

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The Health Insurance Risk-Sharing Plan (HIRSP) is a state program that provides health insurance to individuals who are unable to obtain coverage in the private market. As of September 30, 2002, 15,267 policyholders were enrolled in HIRSP, which represents the highest number in the plan's history.

At the request of the Department of Health and Family Services, we performed a financial audit of HIRSP for fiscal year (FY) 2000-01. During prior audits of HIRSP, we identified a number of financial and management concerns, including issues related to funding, drug claims processing, and overall program administration. This report, which includes an unqualified opinion on HIRSP's FY 2000-01 financial statements, follows up on these issues.

Plan Administration

The Department assumed oversight responsibility for HIRSP in January 1998.

1997 Wisconsin Act 27, which was enacted in October 1997, transferred oversight responsibility for HIRSP from the Office of the Commissioner of Insurance (OCI) to the Department of Health and Family Services as of January 1, 1998. In addition, it modified HIRSP in response to the federal Health Insurance Portability and Accountability Act of 1996 and required responsibility for daily program operations to be transferred to a new plan administrator that is also the State's fiscal agent for the federal Medical Assistance program, or Medicaid. Act 27 also made significant changes to HIRSP's funding, including providing increased general purpose revenue (GPR) and increasing health care providers' funding responsibility.

The transfer of oversight responsibility from the OCI to the Department was intended to bring administration of all state-sponsored medical programs under one agency. As the agency responsible for oversight of HIRSP, the Department is required by statutes to promulgate administrative rules, including rules to:

- establish a program budget for each plan year;
- operate the plan;
- establish annual HIRSP premium rates, deductible amounts, and coinsurance payment rates;
- set and collect insurers' assessments; and

- adjust the provider payment rates as necessary to meet program funding requirements.

During FY 2000-01, the Department was authorized 4.5 positions and $307,431 for salary and fringe benefits, which are funded by segregated fund revenues, to oversee HIRSP operations and policies, as well as to provide administrative support for the 12-member advisory Board of Governors that consists of:

- the Department's Secretary (or a designee), who serves as chair;

- the Commissioner of Insurance (or a designee); and

- 10 members appointed by the Secretary for staggered 3-year terms, including 4 participating insurers (2 representing nonprofit organizations), 3 health care providers, and 3 public members. Effective September 1, 2001, the number of public members was increased to 4, with at least 1 being an individual covered under HIRSP.

The mandated transfer of responsibility for daily program operations to the State's fiscal agent for Medicaid, EDS, was intended to allow HIRSP to take advantage of cost-containment provisions associated with Medicaid. EDS became HIRSP's plan administrator on July 1, 1998, and is responsible for:

- determining whether applicants are eligible for health insurance coverage offered through HIRSP;

- establishing procedures for collecting premiums from insured persons; and

- processing and paying eligible claims in a timely manner.

Plan administrator fees for HIRSP were $3.8 million, or 6.6 percent of total expenses, in FY 2000-01.

Plan administrator fees were $3.8 million in FY 2000-01, which represents 6.6 percent of the program's total operating and administrative expenses during the fiscal year, and an increase of 37.3 percent from FY 1999-2000.

Legislative proposals to eliminate the statutory requirement that the HIRSP administrator be the fiscal agent for Medicaid and instead require the plan administrator to be selected through a competitive procurement process have been introduced, but not passed. Most recently, such a provision was introduced by the Assembly but deleted by the Senate and the full Legislature as part of the 2001-03 budget reform bill deliberations.

Plan Provisions

Three plans are available to policyholders.

HIRSP offers eligible applicants three plans:

- The primary plan provides coverage that is similar to coverage provided by many private major medical plans. It 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.

- The alternative primary plan, which became available in January 1998, offers lower premium rates than the primary plan but requires policyholders to pay a higher deductible before HIRSP begins paying claims. It was introduced 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.

- 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. 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 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 the primary plan, $2,500 for the alternative primary plan, and $500 for plan 2, which must be paid by policyholders before insurance benefits will be available.

- medical coinsurance payments of up to $1,000 per year for policyholders in the primary and alternative primary plans, 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 up to $750 for the primary plan, $1,000 for the alternative primary plan, 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 from the OCI to the Department. Effective January 1, 1998, the Legislature:

- made additional GPR funding available to offset program costs, including $9.9 million in FY 1999-2000, $11.9 million in FY 2000-01, and $10.0 million in FY 2001-02; 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 totals $23.4 million in the 1999-2001 biennium.

In addition, $780,800 in GPR was appropriated in each year, and $1.9 million was provided by insurers and health care providers to fund premium and deductible subsidies for low-income persons during FY 2000-01. In the 1999-2001 biennium, GPR support for HIRSP totaled $23.4 million.

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 expected to fund 60 percent of the remaining estimated operating and administrative costs, are established based on a complex formula enumerated in Appendix 1, which 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. In addition, insurers and health care providers share equally in the excess costs not funded by policyholder premiums.

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, since January 1, 1998. Premium rate increases since 1998 are shown in Table 1.

Table 1

Premium Rate Changes

Effective Date	Primary and Alternative Primary Plans	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

For both the primary plan and the alternative primary plan, 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 the Department to consider enrollment levels and other economic factors in addition to claims costs when establishing premium levels. The ultimate goal of the Department and the Board of Governors is to make the ratio of losses to premiums for plan 2 more comparable to those of the primary plans and reduce the extent to which the primary plans are subsidizing plan 2.

Examples of annual premiums effective July 1, 2002, for policyholders living in Milwaukee, where the rates are the highest, are shown in Table 2.

Table 2

Examples of Annual Premiums for a Policyholder Living in Milwaukee
Rates effective July 1, 2002

Plan Type	Male Ages 0-24	Male Ages 60-64	Female Ages 0-18	Female Ages 60-64
Primary Plan	$2,088	$9,612	$2,088	$8,016
Alternative Primary Plan	1,500	6,924	1,500	5,772
Plan 2	1,536	7,044	1,536	5,868

In FY 2000-01, 29 percent of low-income policyholders received subsidies costing $2.7 million.

Policyholders with annual household incomes below $20,000 are eligible for premium and deductible subsidies. Since January 1, 2000, policyholders with annual household incomes of $20,000 and no more than $25,000 have been eligible for premium subsidies, but not deductible subsidies. As noted, both types of subsidies are funded by GPR and by providers and insurers, who share equally in the subsidy program costs that are not covered by GPR. Annual premium subsidies for policyholders ranged from $120 to $2,400, between July 1, 2000 and June 30, 2001, and deductible subsidies ranged from $200 to $500. In that year, 29 percent of HIRSP policyholders received subsidies costing $2.7 million.

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The Department has taken positive steps to address financial management concerns identified during past audits, including HIRSP's financial stability and the overpayment of pharmacy claims. Additional issues relating to the calculation of actuarial loss liabilities estimates and administrative billing problems suggest that the Department needs to remain diligent in its financial management responsibilities over HIRSP.

Financial Stability

HIRSP has reported accounting deficits since FY 1997-98, which is the first year we began auditing its financial statements. Steps have been taken to establish a more sound basis for funding HIRSP. However, increasing enrollment and claims costs will present continuing challenges in the future management and funding of HIRSP.

Funding Basis

Since we began auditing HIRSP's financial statements, we have recommended that HIRSP be funded on an accrual basis rather than the cash-based approach that had been used at the time. A cash basis takes into account estimated cash disbursements and has the goal of providing cash to pay claims as they are submitted. An accrual basis takes into account the full costs associated with events that occurred during a plan year, including actuarial cost estimates for claims incurred that may not be filed until after the plan year.

HIRSP had an accounting deficit of $8.2 million as of June 30, 2001.

HIRSP's cash-based funding approach contributed to an accounting deficit because it did not factor in claims liabilities that are reported on an accrual basis. Taking into account a reserve for policyholder premiums paid in excess of that required to fund 60 percent of costs, HIRSP's accounting deficit was $8.2 million as of June 30, 2001. That amount represents the estimated amount of additional cash that HIRSP would need to pay its liabilities as of June 30, 2001.

The Department and the Board have approved accrual-based funding for HIRSP.

In April 2001, the Department and the Board of Governors decided, on a 9-3 vote, to implement an accrual-based approach to funding HIRSP. This change was extensively debated by the Board of Governors, the Legislature, and other interested parties because of its immediate fiscal effect on the various parties funding HIRSP. The change to an accrual-based approach requires funding the accounting deficit that has accumulated in the program under a cash-based funding approach, in addition to funding the program's ongoing costs on an accrual basis.

Increasing Enrollment and Claims Costs

The number of HIRSP policyholders is increasing.

HIRSP enrollment and claims costs have been increasing steadily since the Department assumed responsibility for the program in January 1998. As shown in Table 3 and Figure 1, total policyholder enrollment increased to 14,563 as of June 30, 2002, or a 27.1 percent increase during FY 2001-02, and is projected to increase to 17,469 as of June 30, 2003, for another 19.9 percent increase during FY 2002-03. The alternative primary plan has experienced the most significant growth of the three plans: enrollment increased 1,709, or 60.0 percent, during FY 2001-02.

Table 3

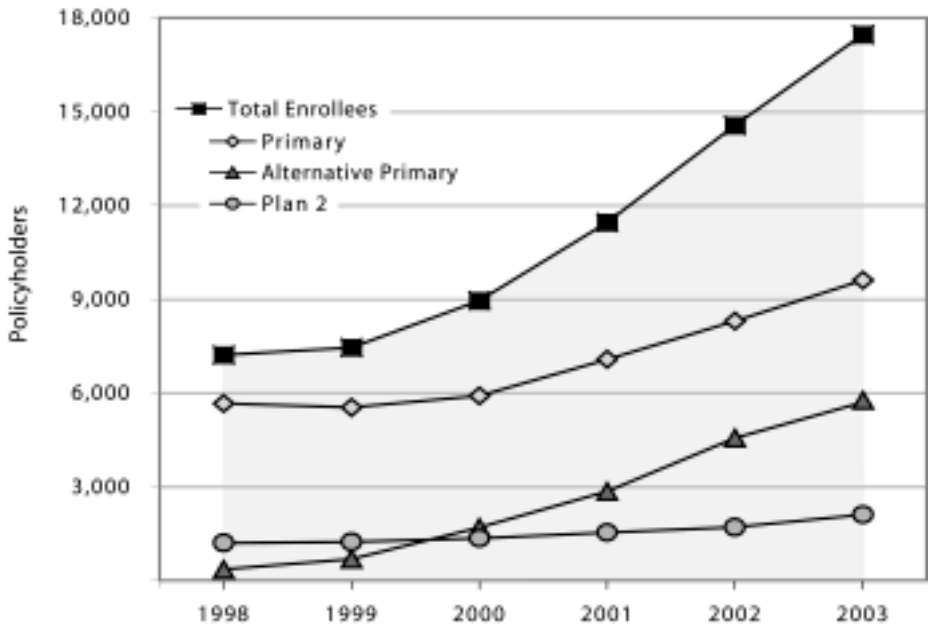
HIRSP Enrollment

Date	Primary Plan	Alternative Primary Plan	Plan 2	Total Policyholders
June 30, 1998	5,660*	354*	1,204	7,218
June 30, 1999	5,540	683	1,231	7,454
June 30, 2000	5,909	1,692	1,348	8,949
June 30, 2001	7,081	2,849	1,530	11,460
June 30, 2002	8,302	4,558	1,703	14,563
June 30, 2003	9,608*	5,765*	2,096*	17,469*

* Estimate/projected

Figure 1

HIRSP Enrollment by Plan
as of June 30



Reasons for the enrollment increases are not entirely clear. In an attempt to better understand the trend, the Department conducted a survey of policyholders in May 2002. Survey results indicate:

- 66.2 percent of HIRSP policyholders could not find insurance elsewhere;

- 10.6 percent had exhausted coverage provided in accordance with provisions of the 1986 Consolidated Omnibus Budget Reconciliation Act (COBRA), which allows terminated employees or those who lose coverage because of reduced work hours to buy employer-sponsored group coverage for themselves and their families for limited periods of time;

- 10.1 percent had lost employer-sponsored group coverage;

- 5.0 percent experienced employer group premium increases greater than 50 percent; and

- 3.6 percent found HIRSP less expensive than other available coverage.

Since 1998, 13 insurers discontinued individual health insurance coverage and 18 insurers discontinued group coverage.

One factor that may be affecting enrollment is the discontinuance of health insurance coverage by some insurance companies. According to the Office of the Commissioner of Insurance, since 1998, 13 insurers offering health insurance in Wisconsin have discontinued individual health insurance coverage, affecting at least 5,699 individuals, and 18 insurers have discontinued group health insurance coverage, affecting at least 13,867 individuals. In addition, enrollment may also be affected as small employers have increased difficulty maintaining health insurance coverage for their employees as insurance costs increase. A direct correlation has not been documented between the discontinued coverage by insurers and small employers and enrollments in HIRSP, but the effect of discontinued health insurance coverage on HIRSP warrants further analysis in understanding enrollment trends.

Like enrollment levels, claims costs are increasing. As shown in Table 4, HIRSP's claims costs, net of health care providers' discounts, have increased significantly during the last two fiscal years. HIRSP's claims costs increased 48.9 percent or $17.7 million during FY 2000-01 and 24.2 percent or $13.1 million during FY 2001-02. A large portion of these increases can be explained by the enrollment increases, although they also are being affected by increases in medical costs similar to those experienced by others in the health insurance industry.

The enrollment and cost trends are increasing required funding levels. For example, projected FY 2002-03 insurer assessments of $26.0 million and health care providers contributions of $23.6 million, which include funding for the accounting deficit, are over three times greater than those of FY 1998-99. If these trends continue, pressures likely will increase to control the costs borne by HIRSP's funding parties and to evaluate the effectiveness of the current funding structure.

Table 4

Claims Costs

Fiscal Year	Amount	Percentage Change
1998-99	$31,519,927	–
1999-2000	36,218,171	15.0%
2000-01	53,939,007	48.9
2001-02*	66,999,278	24.2

* Preliminary unaudited number

Pharmacy Claims

During our FY 1998-99 audit, we found that, in response to complaints from policyholders and pharmacies regarding the Medicaid-based claims system, the Department had suspended controls that ensured HIRSP policyholders and pharmacies were reimbursed for prescription drugs at HIRSP-allowed rates. As a result, HIRSP overpaid drug claims by an estimated $5.2 million for prescriptions dispensed from July 1998 through January 2001. Since we notified the Department of the overpayments in May 2000, it has taken steps to re-establish controls and improve the pharmacy claims process.

HIRSP implemented an on-line processing system for pharmacy claims in 2001.

System controls were reinstated on January 29, 2001, to ensure that drug claims are paid at the allowed rates. However, resumption of system controls and steps to recover overpayments resulted in at least 160 pharmacies withdrawing from HIRSP. To address the pharmacies' concerns and to improve the efficiency, simplicity, and understandability of the drug claims process for both policyholders and pharmacies, the Department contracted with HIRSP's plan administrator to use its pharmacy benefit management company to implement an on-line processing system for pharmacy claims. Under the system, which became operational August 1, 2001, pharmacies have on-line prescription drug pricing information and are able to electronically submit claims data to the plan administrator weekly, so that reimbursements can be made more quickly.

Separate drug coinsurance provisions were implemented in January 2002.

In addition to system improvements, separate drug co-insurance provisions were implemented effective January 1, 2002. Under those provisions, pharmacies charge policyholders a 20 percent coinsurance amount up to a maximum of $25 per prescription, and a yearly maximum of $125 to $1,000, depending on the policyholder's plan. Previously, without separate drug coinsurance provisions, pharmacies frequently required policyholders to pay in full for prescription drugs at the time of purchase. Additionally, separate coinsurance provisions are believed to be beneficial to most policyholders because most policyholders are not required to meet overall deductible levels before HIRSP begins paying drug claims. Department officials note that the separate drug benefit and on-line system appear to be working smoothly. Further, most pharmacies that had previously stopped filling drug prescriptions for HIRSP policyholders have resumed providing prescription drug services.

In 2002, the Legislature directed the Department to discontinue its efforts to recover $5.2 million in drug overpayments.

The Department also took steps to recover the overpayments. In December 2001, it sent notices to approximately 900 pharmacies requesting repayment of the $5.2 million in overpayments. The Pharmacy Society of Wisconsin questioned the Department's authority to seek recovery of the overpayments and sought legislative intervention. In the 2001-03 Budget Reform Act, 2001 Act 109, which took effect on July 30, 2002, the Legislature directed the Department to discontinue its recovery efforts and to return overpayments already collected. As a result, the $5.2 million in overpayments remain a cost of HIRSP that is shared by policyholders, insurers, and other health care providers.

Actuarial Loss Liabilities Estimates

Unpaid loss or claims liabilities represent estimates of what HIRSP will need to pay for covered medical services that have been provided by year-end but have not been paid or even reported. A subcontractor of the plan administrator provides actuarial services to estimate the unpaid loss liabilities for financial reporting. The Department provides the actuary with historical paid claims data for use in estimating unpaid loss liabilities and is responsible for ensuring the accuracy and consistency of the claims data. However, we believe the Department needs to establish a more formal process for establishing and reporting actuarial estimates of unpaid loss liabilities. Inadequate procedures and communication between the Department and the actuary regarding the claims data and the actuarial process led to an estimate that was materially in error, requiring an adjustment to correct financial statement balances as of June 30, 2001.

Loss liabilities were overstated by $1.8 million for FY 2000-01.

In prior years, the Department reported hospital claims by patient discharge date, rather than admission date, which then required an adjustment to estimate claims for services provided to policyholders in the hospital at June 30. In March 2001, the Department began reporting hospital claims by patient admission rather than discharge date, but it did not inform the actuary of the change. As a result, the actuary made a $1.8 million hospital adjustment to the estimated loss liabilities that was not valid. After the error was brought to the Department's attention, it consulted with the actuary and appropriately reduced the loss liabilities by $1.8 million.

We also found inconsistencies between the claims paid data reported by the actuary and the data maintained by the Department, because the Department had not notified the actuary of changes in the reporting of claims data. Fortunately, the differences were not material and did not affect the actuarial estimates.

Historically, two actuaries have been used for HIRSP: one to estimate the loss liabilities for financial reporting, and another to propose funding requirements for policyholders, insurers, and providers. The involvement of two different actuaries may have contributed to confusion as to what information had been communicated to the actuary. The Department and the Board of Governors have recently taken steps to employ only one actuary for HIRSP's actuarial needs. In addition to reducing confusion, the use of one actuary should help to provide a more comprehensive understanding of HIRSP's loss liabilities and funding needs and should eliminate duplication of efforts related to the use of two actuaries.

The Department needs to increase its oversight of HIRSP's actuarial loss liability estimates.

In addition to limiting actuarial audit work to one actuary, we believe the Department needs to increase and formalize its oversight of the actuarial process and estimates. Therefore, *we recommend the Department of Health and Family Services establish formal policies and procedures to*:

- *ensure the data provided, used, and relied upon by HIRSP's actuary are correct and consistent with the Department's data; and*

- *review and approve the actuarial reports and opinions used in HIRSP's operations*.

Administrative Costs

In our first financial audit of HIRSP in 1999 (report 99-6), we raised concerns over the absence of a competitive contracting process for the Department's funding arrangement with HIRSP's plan administrator, EDS. However, the statutorily required use of the State's fiscal agent for Medicaid limits the Department's ability to undertake a competitive procurement process. Consequently, we emphasized the importance of the Department having a disciplined approach for maintaining accountability, justifying changes, and controlling costs. Ongoing administrative billing problems suggest that increased monitoring of billings by the plan administrator is needed.

Because HIRSP is covered under the Department's Medicaid contract with EDS, the Department does not have a separate, formal, written contract for HIRSP. Instead, the Department and the plan administrator agree upon administrative activities and associated fees through signed resource estimates. When the plan administrator assumed administrative responsibilities for HIRSP, an original resource estimate was signed. As the program expanded and additional services became necessary, additional resource estimates were signed. Resource estimates are also signed for special projects that the Department requests the plan administrator to complete. As a result, several resource estimates exist that include a combination of fixed and variable fees to be paid on a monthly basis.

Several problems with the plan administrator's billings have occurred over the last four fiscal years.

Several errors occurred in the billing and payment of the plan administrator's fees over the last four fiscal years. During four months in 1999, May through August, the Department overpaid the plan administrator $264,657 because the plan administrator erroneously billed all hours worked by staff who spent only a portion of their time on HIRSP activities. In September 1999, the Department suspected a billing problem and worked with the plan administrator to establish a credit for the overbilling. However, the plan administrator failed to resume billing the Department once the credit was exhausted in January 2000, until it discovered the error 15 months later in March 2001. The plan administrator informed the Department that a total of $477,081 was due for services provided but not billed over the period, but it ultimately rescinded the billing in January 2002. In December 2001, the plan administrator also notified the Department that it had overcharged and would credit HIRSP $53,467 in excess of a fixed rate agreed upon in one of the resource estimates.

The billing problems have presented budgeting and financial reporting challenges for the Department. For example, because of the lack of timely and accurate administrative billings, administrative costs were not properly presented in prior years' financial statements. The Department is taking steps to address the billing problems. The Department notes that the mix of fixed and variable costs has made it difficult to anticipate the costs billed by the plan administrator. Therefore, it is currently working with the plan administrator to simplify its administrative fees by establishing a flat monthly rate for the routine administrative services that the plan administrator provides, such as ongoing staff costs for system maintenance. The flat monthly rate will improve the Department's ability to anticipate and monitor routine administrative billings, although the Department will need to remain diligent in anticipating and monitoring variable costs, such as for special projects requested of the plan administrator. Additionally, we encourage the Department to work closely with the plan administrator to identify estimated administrative costs at fiscal year-end for financial reporting purposes.

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

We have audited the accompanying balance sheet of the Wisconsin Health Insurance Risk-Sharing Plan as of June 30, 2001 and 2000, and the related statements of revenues, expenses, and changes in retained earnings and of cash flows for the years then ended. 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.

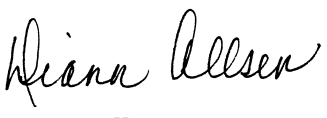
We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform 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 present only the Health Insurance Risk-Sharing Plan and are not intended to present fairly the financial position of the State of Wisconsin and the results of its operations and the cash flows of its enterprise funds in conformity with accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Health Insurance Risk-Sharing Plan as of June 30, 2001 and 2000, and the results of its operations and the cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 10, 2002, 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

October 10, 2002 by 

Diann Allsen
Audit Director

Wisconsin Health Insurance Risk-Sharing Plan
Balance Sheet
June 30, 2001 and 2000

	June 30, 2001	June 30, 2000
Assets		
Cash and Cash Equivalents (Note 2)	$ 18,639,677	$ 17,090,460
Assessments Receivable	35,439	0
Other Receivables	1,592,124	424,214
Prepaid Items	59,208	84,483
Total Assets	$ 20,326,448	$ 17,599,157
Liabilities and Fund Equity		
Liabilities:		
Unpaid loss liabilities (Note 3)	$ 17,168,158	$ 12,792,158
Unpaid loss adjustment expenses (Note 3)	621,900	621,900
Unearned premiums	7,418,496	5,539,938
Accounts payable and other accrued liabilities	1,163,323	692,600
Total Liabilities	26,371,877	19,646,596
Fund Equity:		
Reserved retained earnings for excess policyholder premiums (Note 4)	2,128,863	7,206,914
Unreserved retained earnings (Note 9)	(8,174,292)	(9,254,353)
Total Fund Equity	(6,045,429)	(2,047,439)
Total Liabilities and Fund Equity	$ 20,326,448	$ 17,599,157

The accompanying notes are an integral part of this statement.

Wisconsin Health Insurance Risk-Sharing Plan
Statement of Revenues, Expenses, and Changes in Retained Earnings
for the Years Ended June 30, 2001 and 2000

	For the Year Ended June 30, 2001	For the Year Ended June 30, 2000
Operating Revenues		
Premiums	$ 33,540,723	$ 23,453,792
State Premium Subsidy (Note 6)	599,300	599,300
Revenue from the State of Wisconsin	11,900,000	9,900,000
Insurers' Assessments (Note 5)	9,898,320	6,039,187
Total Operating Revenues	55,938,343	39,992,279
Operating Expenses		
Losses:		
Losses paid or approved for payment	49,945,868	33,301,674
State deductible recoveries (Note 6)	(181,500)	(181,500)
Increase (decrease) in unpaid losses	4,174,639	3,097,997
Total Losses	53,939,007	36,218,171
Change in Unpaid Loss Adjustment Expenses	0	6,672
General and Administrative Expenses (Note 7)	4,291,490	3,390,671
Referral Fees	90,720	54,740
Total Operating Expenses	58,321,217	39,670,254
Net Operating Income (Loss)	(2,382,874)	322,025
Non-Operating Revenues (Expenses)		
Investment Income	882,961	353,219
Distribution to Policyholders (Note 11)	(2,498,077)	0
Total Nonoperating Revenues (Expenses)	(1,615,116)	353,219
Net Income (Loss)	(3,997,990)	675,244
Retained Earnings		
Retained Earnings, Beginning of Year	(2,047,439)	(2,722,683)
Retained Earnings, End of Year	$ (6,045,429)	$ (2,047,439)

The accompanying notes are an integral part of this statement.

Wisconsin Health Insurance Risk-Sharing Plan
Statement of Cash Flows
for the Years Ended June 30, 2001 and 2000

	For the Year Ended June 30, 2001	For the Year Ended June 30, 2000
Cash Flows from Operating Activities		
Cash Received for Premiums	$ 34,808,943	$ 26,308,032
Cash Received for Assessments	9,862,882	6,050,589
Cash Received from State of Wisconsin	11,900,000	9,900,000
Cash Payments for Losses	(49,642,006)	(31,888,870)
Cash Payments for Other Expenses	(3,749,207)	(3,857,164)
Cash Distribution to Policyholders	(2,498,077)	0
Net Cash Provided (Used) by Operating Activities	682,535	6,512,587
Cash Flows from Investing Activities		
Investment Income	866,682	353,219
Net Cash Provided (Used) by Investing Activities	866,682	353,219
Net Increase in Cash and Cash Equivalents	1,549,217	6,865,806
Cash and Cash Equivalents, Beginning of Year	17,090,460	10,224,654
Cash and Cash Equivalents, End of Year	$ 18,639,677	$ 17,090,460

Reconciliation of Net Operating Loss to Net Cash Provided by Operating Activities

Net Operating Income (Loss)	$ (2,382,874)	$ 322,025
Adjustments to Reconcile Net Operating Loss to Net Cash Provided by Operating Activities:		
Cash distribution to policyholders	(2,498,077)	0
Changes in assets and liabilities:		
Decrease (increase) in receivables	(1,187,070)	1,158,958
Decrease (increase) in prepaids	25,275	(83,228)
Increase (decrease) in accounts payable	470,723	(469,470)
Increase (decrease) in unearned premiums	1,878,558	1,625,918
Increase (decrease) in loss liabilities	4,376,000	3,958,384
Total Adjustments	3,065,409	6,190,562
Net Cash Provided (Used) by Operating Activities	$ 682,535	$ 6,512,587

The accompanying notes are an integral part of this statement.

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. The Department uses independent third-party administrators to provide underwriting, claims settlement, 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. 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. 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 (GAAP) 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.

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 8. 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 in the period covered by the assessment.

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 $880,820 at June 30, 2001, and $7,907,991 at June 30, 2000. The bank balance was $1,895,592 at June 30, 2001, and $8,370,095 at June 30, 2000. 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, 2001, and June 30, 2000, $400,000 was insured and classified in risk category 1; $1,495,592 at June 30, 2001, and $7,970,095 at June 30, 2000, 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 $17,656,548 as of June 30, 2001, and $9,182,262 as of June 30, 2000.

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 2000-01 and 1999-2000 (in thousands):

	FY 2000-01	FY 1999-2000
Balance, beginning of year	$13,414	$ 9,456
Incurred claims:		
Provision for insured events of the current fiscal year	57,688	40,497
Changes in provision for insured events of prior calendar years	(3,010)	(2,072)
Total incurred	54,678	38,425
Payments:		
Claims attributable to insured events of the current calendar year	40,212	27,889
Claims attributable to insured events of prior calendar years	10,090	6,578
Total paid	50,302	34,467
Balance, end of year	$17,790	$13,414

4. Reservation of Retained Earnings for Excess Policyholder Premiums

Section 149.143(2m)(a), Wis. Stats., requires the Department 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., to reduce premiums to a floor of 150 percent of standard risk rates when premiums exceed the policyholders' share of plan costs in future plan periods, or to allow excess premiums to be used for other needs of eligible persons, with the approval of the Board of Governors.

The excess policyholder premium amount for FY 1999-2000 is determined on a cash-based budget. The excess premium amount for FY 2000-01 is determined on an accrual basis because of an April 2001 vote by the Board of Governors to change to an accrual-based budgeting approach.

5. 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.

6. Premium and Deductible Subsidies

HIRSP provides a premium and deductible subsidy program to reduce premium and deductible levels that would otherwise be paid by low-income policyholders. HIRSP policyholders with annual household incomes below $25,000 were eligible for a premium subsidy. Policyholders with incomes below $20,000 were eligible for a deductible subsidy. 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 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.

Individuals eligible for the subsidy program pay premiums based on reduced percentages of standard risk, as shown in the following table. The premium subsidy is not available for policyholders in the alternative primary plan. The deductible subsidy is only available for policyholders in the primary plan, in which unsubsidized deductibles are $1,000.

Annual Household Income		Amount of Premium as %	Reduction in
at Least	but Less Than	of Standard Risk Rates	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-nine percent of HIRSP policyholders received subsidies costing $2,701,622 in FY 2000-01, and $2,158,600 in FY 1990-2000. For FY 2000-01, premium subsidies were $2,182,758 and deductible subsidies were $518,864. For FY 1999-2000, premium subsidies were $1,694,767 and deductible subsidies were $463,833. A total of $780,800 of GPR was appropriated and spent for premium and deductible subsidies in FY 2000-01 and FY 1999-2000. Costs in excess of GPR appropriated for this purpose were shared equally by health insurers and health care providers, with each contributing $960,000 in FY 2000-01 and $689,000 in FY 1999-2000.

7. General and Administrative Expenses

General and administrative expenses include the following:

	FY 2000-01	FY 1999-2000
Plan administrator fees	$3,848,940	$2,803,246
State administrative costs	379,332	287,998
Other expenses	63,218	299,427
Total	$4,291,490	$3,390,671

As indicated in Note 12, a prior-period adjustment of $315,646 was made to correct understated administrative expenses for FY 1999-2000.

8. Health Care Providers' Contributions

Statutes prescribe that health care providers 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.

The Department estimates the provider contributions attributable to funding HIRSP were $11,616,786 for FY 2000-01 and $8,643,355 for FY 1999-2000. 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. The Department used these provider contribution amounts to assess whether providers were providing their required level of funding for HIRSP.

9. Negative Retained Earnings

Negative retained earnings have resulted, in large part, because HIRSP has 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.

10. Subsequent Event

In May 2000, it was determined 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, the Department sent letters to approximately 900 pharmacies requesting repayment of $5.2 million. Subsequently, with the enactment of 2001 Wisconsin Act 109, the Legislature prohibited the Department from recovering the overpayments and required it to return any recoveries already received before the Act's effective date of July 30, 2002.

In January 2002, the plan administrator rescinded administrative invoices totaling $477,081 that had been accrued as of June 30, 2001.

11. Policyholder Distribution

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

12. Prior-Period Adjustment

The financial statements for FY 1999-2000 are restated to correct an error in accruing administrative expenses. Administrative expenses and liabilities are increased by $315,646 to adjust for administrative expenses that had not been accrued at year-end.

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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 as of and for the years ended June 30, 2001, and June 30, 2000, and have issued our report thereon dated October 10, 2002. We conducted our audits in accordance with auditing standards generally accepted in the United States 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.* We found 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, as discussed in the accompany report section titled "Pharmacy Claims" and Note 10 of the financial statements. The Department reinstated system controls on January 29, 2001. The Department also initiated steps to recover the overpayments, but the Legislature subsequently directed the Department to discontinue its recovery effort and return any recoveries already received.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over the Plan'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.

This independent auditor's report is intended for the information and use of the Department's management and the Wisconsin Legislature's Joint Legislative Audit Committee. 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

October 10, 2002 by 

Diann Allsen
Audit Director

Appendix 1

Payment of HIRSP Operating and Administrative Costs

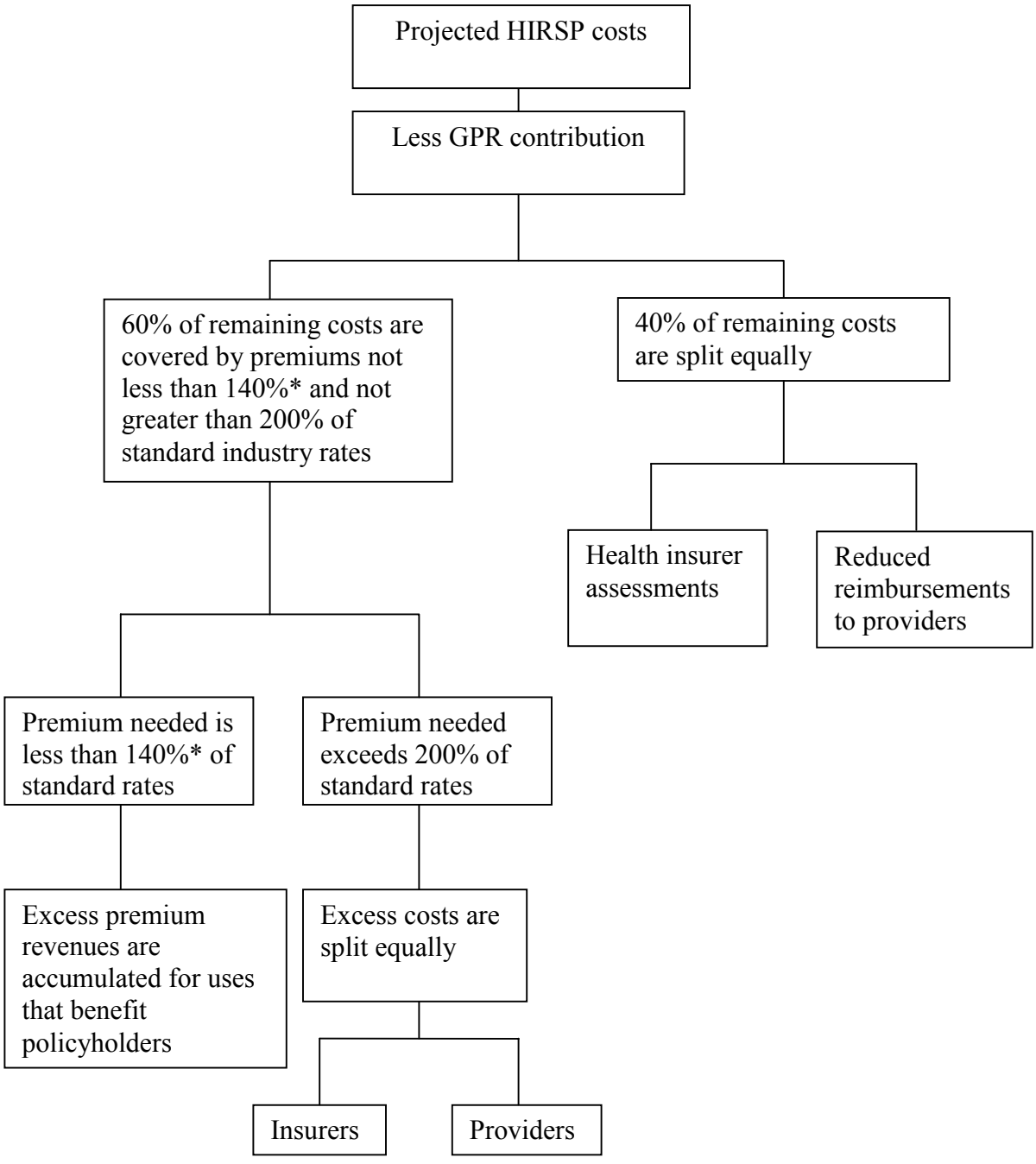
Statutes prescribe a funding formula for HIRSP that requires policyholders, private health insurers, and health care providers to share in estimated operating and administrative costs remaining after the GPR contribution has been deducted. Policyholder premiums are expected to fund 60 percent of the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

Payment of Operating and Administrative Costs
As of July 30, 2002



* 150% before July 30, 2002

State of Wisconsin
Department of Health and Family Services

Scott McCallum, Governor
Phyllis J. Dubé, Secretary

October 23, 2002

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 audit performed by the Legislative Audit Bureau (LAB) of the SFY 2001 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 staff for working with DHFS staff and with the HIRSP plan administrator to conduct a comprehensive audit.

We are proud that LAB's audit report recognizes that DHFS and the HIRSP Board have been, and continue to be, diligent in our administration of HIRSP. The Department and the HIRSP Board, with the support of the Legislature, achieved these major accomplishments within recent years:

- Converted from a cash basis to an accrual basis of accounting so that estimated liabilities are taken into account in establishing the budget. The change to accrual accounting was recommended by LAB as one way to help ensure the long-term financial stability and viability of HIRSP.

- Resolved previous issues with processing prescription drug claims to preserve a provider network that continues to provide access to prescription drugs for HIRSP policyholders.

- Implemented new statutory provisions related to prescription drug coinsurance to make it easier for HIRSP policyholders and their providers to know what the policyholder's cost-sharing obligation is for prescription drugs covered by HIRSP. This makes it easier for policyholders to obtain needed medications.

- Maintained stable customer service, enrollment, claims processing and fiscal processes during periods of significant growth in HIRSP enrollment. Enrollment has increased more than 100 percent since 1998.

We take very seriously our responsibility to effectively and efficiently administer HIRSP. We appreciate LAB's efforts to identify areas where we can continue to improve our procedures, and we concur with their recommendations regarding the need to increase our oversight of actuarial loss liability estimates. We have already taken several steps to assure the accuracy of data used to develop loss liability estimates for HIRSP:

- Met with DHFS staff, actuaries, and contractor staff involved in reporting or analyzing financial data to review the situations described in the report and to underscore the importance of communication and accurate data.

- Obtained the concurrence of the HIRSP Board to discontinue the use of two actuaries, a practice implemented when the Office of the Commissioner of Insurance (OCI) administered HIRSP. The actuarial firm of Milliman USA will provide the actuarial services to estimate the unpaid loss liabilities and will continue to provide other HIRSP-related actuarial services.

- Obtained Board approval for the actuary to provide monthly loss liability estimates for monthly financial reports and actuarial opinions on the estimate for both the calendar and fiscal year ends, instead of only for the fiscal year end.

- Obtained Board approval that the Board's Financial Oversight Committee will review the loss liability estimates.

The audit report also notes errors in billing and payment of fees to the HIRSP plan administrator. As the audit report points out, we are working to simplify administrative fees. Beginning in November 2002, we will implement a streamlined fee structure for our plan administrator that has been approved by the HIRSP Board. We believe this will improve the billing process and make it easier to monitor invoices. We will continue to review our procedures and will also continue to address issues as they arise.

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

Sincerely,

Phyllis J. Dubé
Secretary