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September 2007

An Audit

Health Insurance Risk-Sharing Plan

Department of Health and Family Services

2007-2008 Joint Legislative Audit Committee Members

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September 26, 2007

Senator Jim Sullivan and
Representative Suzanne Jeskewitz, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Sullivan 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) 2005-06. HIRSP provides medical and prescription drug insurance for individuals who are unable to obtain coverage in the private market or who have lost employer-sponsored group health insurance. We have provided an unqualified opinion on HIRSP's financial statements.

Policyholder enrollment and claims costs are beginning to moderate. Enrollment decreased 3.8 percent during FY 2005-06 and 5.6 percent during FY 2006-07, to reach 17,612 as of June 30, 2007. Following four years of double-digit increases, net claims costs decreased by 1.2 percent during FY 2005-06. Most notably, prescription drug costs decreased by $2.0 million. The creation of the federal Medicare Part D prescription drug coverage program has been a major contributing factor to these recent trends.

Correspondingly, HIRSP has maintained a sound financial position. The decrease in costs as well as an increase in revenues resulted in a $4.2 million dollar increase in HIRSP's unrestricted net asset balance, which totaled $3.9 million as of June 30, 2006.

A balance of excess policyholder premiums increased by $10.0 million during FY 2005-06 and reached $19.5 million as of June 30, 2006. At the direction of HIRSP's governing board, $13.3 million of that amount was applied toward the policyholders' share of costs, which has helped to limit premium increases for policyholders.

2005 Wisconsin Act 74 made significant changes to HIRSP. Among the most significant is the creation of the HIRSP Authority, which assumed oversight responsibility from DHFS on July 1, 2006. The Authority is currently pursuing several additional statutory changes, which are pending in the Legislature.

We appreciate the courtesy and cooperation extended to us by DHFS and the HIRSP plan administrator.

Respectfully submitted,

Janice Mueller
State Auditor

JM/DA/ss

Report Highlights ■

HIRSP has maintained a sound financial position since FY 2002-03.

Policyholder enrollment and claims costs are beginning to moderate.

HIRSP is undergoing several significant program and operational changes.

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

Program costs are shared by policyholders, health insurance companies that do business in Wisconsin, and health care providers. During fiscal year (FY) 2005-06, HIRSP also received $2.5 million in federal funds designated for high-risk health insurance pools.

HIRSP offers eligible applicants three plans:

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

At the request of the Department of Health and Family Services (DHFS), we completed a financial audit of HIRSP. Our audit report contains our unqualified opinion on HIRSP's financial statements and related notes as of and for the fiscal years ending June 30, 2006 and 2005.

Financial Status

At the end of FY 2000-01, HIRSP reported a significant accounting deficit, with unrestricted assets of ($8.2 million). After implementing an accrual-based funding approach, HIRSP's financial position improved significantly. At the end of FY 2005-06, it reported an unrestricted net asset balance of $3.9 million, as shown in Table 1.

Table 1

Unrestricted Net Assets
(in Millions)

Date	Amount
June 30, 2001	$(8.2)
June 30, 2002	(6.0)
June 30, 2003	(0.9)
June 30, 2004	6.8
June 30, 2005	(0.3)
June 30, 2006	3.9

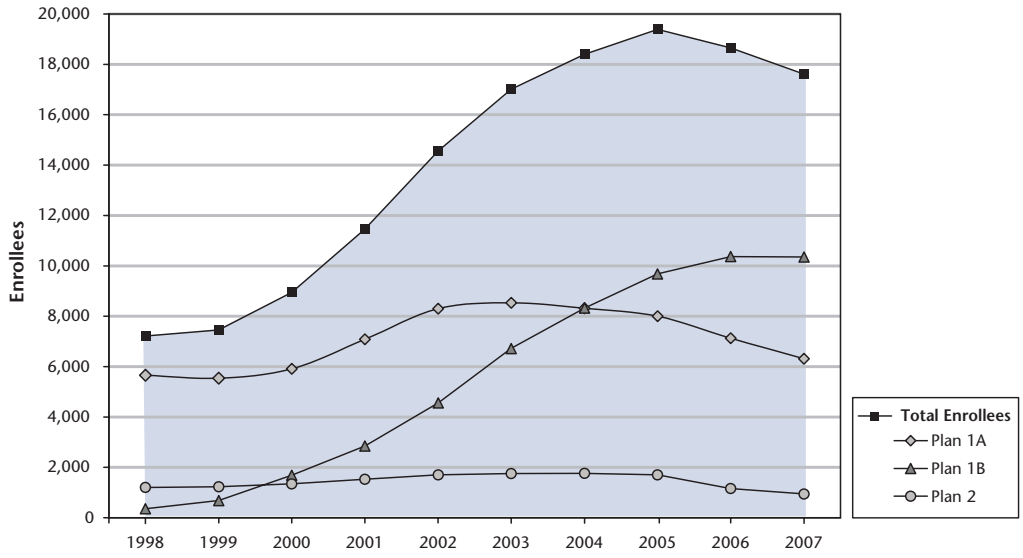
A balance of excess policyholder premiums increased by $10.0 million during FY 2005-06 and reached $19.5 million as of June 30, 2006. At the direction of HIRSP's governing board, $13.3 million of that amount was applied toward the policyholders' share of costs, which has helped to limit subsequent premium increases. The excess premium balance accumulated over the past several years, because the statutory floor for premium rates has typically been greater than premiums needed to fund the policyholders' share—60 percent—of HIRSP's costs. Statutory changes implemented as part of 2005 Wisconsin Act 74 removed the statutory premium floor effective July 1, 2006.

Enrollment and Claims Costs

Increasing HIRSP enrollments and increasing claims costs have presented management and funding challenges for several years. However, more recent trends suggest that enrollment and costs are beginning to moderate. HIRSP enrollment decreased 3.8 percent during FY 2005-06 and 5.6 percent during FY 2006-07, to reach 17,612 at June 30, 2007, as shown in Figure 1.

Figure 1

HIRSP Enrollment by Plan
As of June 30



The most significant change in enrollment has been in plan 2, which is available to disabled Wisconsin residents under the age of 65 who participate in Medicare and is used by many for prescription drug coverage. Over the last two fiscal years, enrollment in plan 2 decreased by 44.5 percent. The decrease is largely attributable to the requirement that, beginning in May 2006, plan 2 policyholders must also enroll in the federal Medicare Part D prescription drug coverage program.

HIRSP's net claims costs, which represent amounts actually paid, decreased by 1.2 percent during FY 2005-06, as shown in Table 2. In the previous four years, net claims costs had increased by double digits. A major part of the FY 2005-06 decrease in net claims costs

was a $2.0 million, or 4.4 percent, decrease in prescription drug costs. That decrease is attributable, in part, to plan 2 participants leaving HIRSP as they enrolled in the Medicare Part D program. Costs savings were also achieved through a change in HIRSP's prescription drug formulary and increased rebates implemented when a new pharmacy benefit management company began administering HIRSP in April 2005.

Table 2

Net Claims Costs[1]
(in Millions)

Fiscal Year	Amount	Change
2000-01	$ 54.1	–
2001-02	67.2	24.2%
2002-03	85.8	27.7
2003-04	103.9	21.1
2004-05	130.4	25.5
2005-06	128.9	(1.2)

[1] Net of health care providers' contributions

Finally, recent shifts in enrollment from plan 1A to plan 1B have contributed to more stable medical costs during FY 2005-06. In the last quarter of FY 2005-06, plan 1A costs were $1,080 per member per month. Plan 1B costs were $546 per member month.

Program Changes

2005 Wisconsin Act 74 created the HIRSP Authority, which assumed responsibility for HIRSP on July 1, 2006. The HIRSP Authority is not a state agency and is not subject to the State's budgeting process, but some level of public accountability is retained through open records and open meetings requirements. The Audit Bureau will also be required to audit HIRSP on an annual basis.

Act 74 also made several other significant changes to HIRSP, including:

- simplifying the complex funding formula;
- providing the HIRSP Authority further flexibility in establishing plan design;
- tightening eligibility requirements; and
- establishing tax credits for the insurers that help to fund HIRSP.

During its first year of operations, the HIRSP Authority and its Board of Directors have identified several areas of HIRSP's program and operations for which they are seeking statutory changes. The most significant changes proposed, which are included in 2007 Senate Bill 226/Assembly Bill 445 and subsequent amendments, include:

- expanding the network of pharmacists and pharmacies that can serve HIRSP policyholders;
- changing the calculation of provider payment rates from Medicaid-based rates to rates established by the HIRSP Authority Board;
- expanding the subsidy programs to all plan options for individuals below specified income levels;
- changing the determination of premium subsidies from a percentage of standard-risk rates to a discount that reduces the unsubsidized premium rate by a specified percentage based on income level; and
- allowing HIRSP funds to be invested in the State Investment Fund, which is administered by the State of Wisconsin Investment Board.

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Introduction ■

At the request of DHFS, which had oversight responsibility for HIRSP through June 30, 2006, we have completed a financial audit for FY 2005-06. We reviewed HIRSP's control procedures, assessed the fair presentation of the FY 2005-06 financial statements, and reviewed compliance with statutory provisions. Wisconsin Physicians Service Insurance Corporation (WPS) functioned as the plan administrator during the period we audited.

The HIRSP Authority created under 2005 Wisconsin Act 74 assumed responsibility for HIRSP on July 1, 2006. As required by Act 74, WPS continues to serve as the plan administrator under a contract with the HIRSP Authority.

Plan Provisions

Three plans are available to policyholders.

HIRSP offers eligible applicants three plans:

- Plan 1A is available for Wisconsin residents who have received a notice of rejection, cancellation, reduction of coverage, or substantial premium increase by an insurer; who have tested positive for the virus that causes AIDS; or who have lost employer-sponsored group health insurance and meet other specified criteria.

- Plan 1B is an alternative plan that was introduced in 1998 to comply with a federal HIPAA requirement to offer a choice of major medical expense coverage to the same individuals eligible for the primary plan.

- Plan 2 is available to Wisconsin residents under the age of 65 who participate in the federal Medicare program because of a disability. Persons with coverage when they reach the age of 65 may continue in the plan. Effective May 15, 2006, plan 2 is available only to policyholders who are also enrolled in Medicare Parts A, B, and D.

Plan Funding

In FY 2005-06, HIRSP received $2.5 million in federal grant funds designated for high-risk health insurance pools.

In FY 2005-06, HIRSP received $2.5 million from the federal Centers for Medicare and Medicaid Services. These federal grant funds were available to qualified high-risk health insurance pools that met certain criteria and, as required under the grant agreement, they were used for operating costs. HIRSP also received a $4.4 million federal high-risk pool grant in FY 2006-07.

However, HIRSP is funded primarily through policyholder premiums, financial assessments on health insurance companies that do business in Wisconsin, and reduced reimbursements to health care providers. Statues require that policyholder premiums fund 60 percent of HIRSP's estimated operating and administrative costs. 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 annually, which must be paid by policyholders in plans 1A and 1B— but not plan 2—after their annual deductible requirements have been satisfied; and

- drug coinsurance payments of 20 percent, or $25 maximum per drug, up to $750 for policyholders in plan 1A, $1,000 for policyholders in plan 1B, and $125 for policyholders in plan 2.

The remaining 40 percent of program costs are to be funded equally by the insurers and health care providers, who also are equally responsible for the premium, deductible, and drug co-insurance subsidies available to low-income policyholders. Insurers fund their share of HIRSP's annual operating and administrative costs through annual assessments that are proportionately based on their annual revenue from health insurance premiums. Health care providers contribute through reduced reimbursements for billed services.

By statute, HIRSP covers only those medical services that policyholders obtain through Medicaid-certified providers. These providers submit bills for services rendered, but they are paid by HIRSP at set rates that are known as "allowable charges." Allowable charges are generally a percentage of Medicaid reimbursement rates.

Providers' contributions reflect the difference between HIRSP's "usual and customary" rate and its allowable charges.

To calculate the providers' share of program funding, HIRSP also relies on a discount rate—the "usual and customary" discount rate—that is applied to billed charges from health care providers. The difference between HIRSP's higher "usual and customary" rate and its lower "allowable charges" rate represents the providers' contributions to HIRSP's funding.

Policyholder Premiums

Premium rates may not exceed 200 percent of average industry rates for standard-risk individuals.

Premium rates for each of HIRSP's three plans differ on the basis of policyholders' gender, age, and geographic location and may not exceed 200 percent of average industry rates for standard-risk individuals. During our audit period, premium rates were also required to be at least 140 percent of the average industry rates. The effect of gender and age on rates can be seen in Table 3, which shows examples of annual premiums effective July 1, 2007, for policyholders living in Milwaukee, where the rates are the highest.

Table 3

Examples of Annual Premiums for Policyholders Living in Milwaukee
Rates Effective July 1, 2007

Plan Type	Male Ages 0-24	Male Ages 60-64	Female Ages 0-18	Female Ages 60-64
Plan 1A	$3,252	$13,272	$3,240	$11,616
Plan 1B	2,016	9,564	1,980	7,740
Plan 2	1,404	6,348	1,404	5,880

Rate increases for both plan 1A and plan 1B generally had been comparable to those that private insurers charge for individual standard-risk policies that provide substantially the same coverage and deductibles. However, HIRSP's premium rates have moderated recently, after its governing board directed that $13.3 million of an accumulated balance of policyholder premiums be applied toward the policyholders' share of costs during FY 2006-07 and the last six months of calendar year 2007. As shown in Table 4, the FY 2006-07 composite premium rate increase for plans 1A and 1B was 5.0 percent, which was significantly less than the average increase of 13.3 percent in the previous five years. Rates for plans 1A and 1B are unchanged from July 1, 2007, through December 31, 2007.

Table 4

Composite 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
July 1, 2004	12.2% Increase	18.4% Increase
July 1, 2005	15.0% Increase	20.3% Increase
July 1, 2006	5.0% Increase	21.5% Decrease
July 1, 2007	No Change	20.0% Decrease

Premium rates for plan 2 have decreased significantly during the last two years.

Premium rates for plan 2, which is available for certain Medicare participants, decreased significantly during the last two years—21.5 percent on July 1, 2006, and an additional 20.0 percent on July 1, 2007—largely because of the federal Medicare Part D prescription drug coverage program. Since May 15, 2006, plan 2 policyholders have been required to enroll in Medicare Part D, which serves as the first payer of their pharmacy costs.

HIRSP met the definition of a federally qualified State Pharmaceutical Assistance Program beginning in July 2006. Such

state-financed and administered programs provide pharmaceutical assistance to certain populations that often include seniors. As a qualified program, HIRSP may pay policyholders' out-of-pocket costs for the Medicare Part D program and those costs can count toward the policyholders' Medicare deductible and co-insurance obligations. As a result of participation in the Medicare Part D program, HIRSP's costs are reduced for plan 2 participants. Premiums have been adjusted to reflect those lower costs.

In FY 2005-06, 18.0 percent of HIRSP policyholders received subsidies, at a cost of $6.0 million.

Under Wisconsin Statutes, plan 1A and plan 2 policyholders who have annual household incomes below $25,000 are eligible for premium subsidies. Plan 1A policyholders with annual household incomes below $20,000 are also eligible for deductible and drug coinsurance subsidies. Plan 1B policyholders are not eligible for any of the subsidies. In FY 2005-06, 18.0 percent of HIRSP policyholders received subsidies from the program, at a cost of $6.0 million.

Program Changes

2005 Wisconsin Act 74 created a quasi-public authority that assumed oversight responsibility for HIRSP on July 1, 2006. The HIRSP Authority's governing Board of Directors consists of 13 voting members appointed by the Governor with the advice and consent of the Senate. Act 74 required the Board to include representatives of insurers, health care providers, and small businesses; HIRSP policyholders; and a professional consumer advocate. The Commissioner of Insurance or a designee also serves as a nonvoting member.

2005 Wisconsin Act 74 made several significant changes to HIRSP.

Because the HIRSP Authority is not a state agency, its operating budget is not subject to approval by the Legislature, and a fund outside of the State's control was established for payment of HIRSP's operating and administrative expenses. However, the HIRSP Authority is a public body corporate and politic that is subject to open records, open meetings, and competitive bidding requirements, and its records are available to the Department of Administration and the Legislative Fiscal Bureau. The law requires annual financial audits to continue to be conducted by the Audit Bureau. In addition:

- HIRSP's complex funding formula has been simplified, although policyholder premiums continue to fund 60 percent of costs, and insurers and providers each continue to fund 20 percent of costs. However, subsidy costs are first to be paid from any federal funds received and then to be equally funded by insurers and providers.

- The HIRSP Authority is allowed to establish the plan design on or after January 1, 2007. Certain services specified by statutes must be covered, but the HIRSP Authority may change benefit levels, deductibles, copayment and coinsurance requirements, exclusions, and limitations that it determines generally reflect and are commensurate with comprehensive health insurance coverage offered in the private individual market in Wisconsin.

- HIRSP applicants must reside in Wisconsin for three months, instead of the 30 days required under prior law, and they must have been rejected by two insurers instead of one within nine months.

- Tax credits were established to help offset the costs of insurers that pay HIRSP assessments. The amount of credit for all insurers cannot exceed $5.0 million annually.

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Program Management ■

HIRSP has maintained a sound financial position as enrollment and claims costs have moderated in recent years. The HIRSP Authority currently is pursuing several statutory changes that affect several aspects of HIRSP's operations.

Financial Status of the Plan

HIRSP has maintained a sound financial position since FY 2002-03.

As shown in Table 5, HIRSP has maintained a sound financial position since FY 2002-03. At the end of FY 2000-01, under its original cash-based funding approach, HIRSP reported a significant accounting deficit, with unrestricted net assets of ($8.2 million). Beginning with FY 2001-02, an accrual-based funding approach was adopted to account for the full costs associated with events that occur during a plan year, including actuarial cost estimates for incurred claims that may not be filed until after the plan year. The change to an accrual-based approach required funding to eliminate the accumulated accounting deficit and funding for newly incurred costs, but it contributed to significant improvements in HIRSP's unrestricted net asset balance.

Table 5

Net Asset Balances
(in Millions)

Date	Total Net Assets	Restricted for Excess Policyholder Premiums[1]	Unrestricted Net Assets[2]
June 30, 2001	$(6.1)	$ 2.1	$(8.2)
June 30, 2002	(3.0)	3.0	(6.0)
June 30, 2003	9.5	10.4	(0.9)
June 30, 2004	16.9	10.1	6.8
June 30, 2005	9.2	9.5	(0.3)
June 30, 2006	23.4	19.5	3.9

[1] The balance of excess policyholder premiums was restricted for statutorily defined purposes through June 30, 2006.
[2] The unrestricted net assets balance represents the net amount available for HIRSP's general operations. A negative balance represents the additional amount needed to pay covered expenses that were incurred but not yet paid as of that date.

In FY 2004-05, HIRSP's unrestricted net asset balance decreased $7.1 million, to a deficit of $300,000 as of June 30, 2005. At least a portion of the decrease was expected in response to a Board of Governors' decision to apply $3.9 million in accumulated insurers' and providers' balances toward FY 2004-05 expenses. However, an unexpected large increase in claims costs contributed to a larger decrease than expected and to the small deficit. The deficit balance was considered in establishing funding requirements for FY 2005-06, and HIRSP ended FY 2005-06 with a positive unrestricted net asset balance of $3.9 million, an increase of $4.2 million from the prior year.

The excess premium balance increased to $19.5 million as of June 30, 2006.

At the same time, the net asset balance restricted for excess policyholder premiums increased by $10.0 million during FY 2005-06 to reach $19.5 million as of June 30, 2006. During our audit period, statutes required a separate accounting of premiums received in excess of the amount needed to cover policyholders' 60 percent share of HIRSP's costs. Statutes restricted the use of these premiums to the following purposes:

- to reduce policyholder premiums to the statutory minimum when the policyholders' share of costs would otherwise require a premium increase;

- for other needs of eligible persons, with the approval of the Board of Governors; or

- for distribution to eligible persons.

The excess premium balance has accumulated over the past several years because the statutory floor for premium rates has typically been greater than the premiums needed to fund the policyholders' share—60 percent—of HIRSP's costs. The large increase in FY 2005-06 also resulted because the average increase in medical costs of 7.0 percent for plans 1A and 1B was significantly less than the 25.0 percent increase projected when establishing the budget and premium rates for that year.

In February 2006, HIRSP's Board of Governors directed that $8.7 million of the excess premium balance be applied toward the policyholders' share of costs in FY 2006-07, which limited the premium increases during that year. Similarly, the Board of Directors for the HIRSP Authority directed that another $4.6 million of the balance be applied toward the policyholders' share of costs for the last six months of calendar year 2007. As noted, these decisions have helped to limit premium increases for those periods.

2005 Wisconsin Act 74 simplifies HIRSP's complex funding formula.

Simplifications to HIRSP's complex funding formula that were enacted in 2005 Wisconsin Act 74 removed both the statutory floor for premium rates and the requirement for a separate accounting of the difference between premiums received and the amount necessary to cover 60 percent of plan costs. Beginning July 1, 2006, net assets are not statutorily restricted for excess policyholder premiums. Further, the elimination of the statutory premium floor provides the HIRSP Authority additional flexibility in establishing premium rates that more closely correlate to the policyholders' share of costs.

The HIRSP Authority's Board approved a minimum net asset policy in April 2007.

In light of the increased flexibility provided under Act 74, the HIRSP Authority has taken additional steps to maintain a sound financial position. Most significantly, it has established a policy regarding HIRSP's minimum net asset level based on an analysis of the policies of other states' high risk pools, on capital requirements for health insurance companies doing business in Wisconsin, and on an opinion from the Office of the Commissioner of Insurance. In April 2007, the HIRSP Authority's Board set a minimum net asset balance of approximately $15.5 million. The HIRSP Authority also has changed its reporting period to a calendar year beginning with 2008.

Act 74, however, did not change how premium levels for policyholders who receive premium subsidies would be established.

Currently, s. 149.165, Wis. Stats., requires premiums for policyholders receiving subsidies to be set at a certain percentage of standard-risk rates that are charged by other insurers for providing substantially the same coverage and deductibles as HIRSP. However, with the removal of the premium floor, subsidized premium rates set in accordance with current statutes could be higher than nonsubsidized rates. They may have been higher during FY 2005-06 if the floor had been removed at that time. 2007 Senate Bill 226, which was introduced in July 2007, would address this concern by establishing premium discounts ranging from 10 to 30 percent of unsubsidized premiums, based on policyholders' income levels.

Enrollment and Claims Costs

HIRSP enrollment decreased in FY 2005-06 and FY 2006-07.

HIRSP's increasing enrollment and claims costs have presented management and funding challenges for several years, although more recent trends suggest that enrollment and costs are beginning to moderate. As shown in Table 6, 18,650 policyholders were enrolled in the three available plans as of June 30, 2006. Total enrollment declined 3.8 percent during FY 2005-06. The decrease in enrollment continued into FY 2006-07, and total enrollment was 17,612 as of June 30, 2007.

Table 6

HIRSP Enrollment

Date	Plan 1A	Plan 1B	Plan 2	Total Policyholders	Percentage Change
June 30, 1998	5,660[1]	354[1]	1,204[1]	7,218	–
June 30, 1999	5,540	683	1,231	7,454	3.3%
June 30, 2000	5,909	1,692	1,348	8,949	20.1
June 30, 2001	7,081	2,849	1,530	11,460	28.1
June 30, 2002	8,302	4,558	1,703	14,563	27.1
June 30, 2003	8,532	6,729	1,756	17,017	16.9
June 30, 2004	8,312	8,319	1,764	18,395	8.1
June 30, 2005	8,000	9,683	1,702	19,385	5.4
June 30, 2006	7,125	10,368	1,157	18,650	(3.8)
June 30, 2007	6,311	10,356	945	17,612	(5.6)

[1] Estimated

Enrollment in plan 1A continued to decrease, while enrollment in plan 1B increased in FY 2005-06 and remained steady in FY 2006-07. The shift in enrollment from plan 1A to plan 1B is likely attributable to the lower premiums in plan 1B. The most significant change in enrollment, however, has been in plan 2, which reported a 44.5 percent decrease in enrollment over the last two fiscal years. The decrease is largely attributed to the availability of the Medicare Part D program in November 2005, and the requirement that plan 2 policyholders, many of whom enroll in HIRSP for prescription drug coverage, must also enroll in the Medicare Part D program beginning May 15, 2006.

Following four years of double-digit increases, net claims costs decreased by 1.2 percent during FY 2005-06.

HIRSP's net claims costs, which represent amounts actually paid, decreased by 1.2 percent during FY 2005-06, as shown in Table 7. In the previous four years, net claims costs had increased by double digits. A major cause of the 1.2 percent decrease in FY 2005-06 was a $2.0 million, or 4.4 percent, decrease in prescription drug costs. That decrease is attributable, in part, to plan 2 participants leaving HIRSP and enrolling in the Medicare Part D prescription drug program. In addition, HIRSP incurs only limited prescription drug costs for the plan 2 policyholders who continue coverage, until they reach the Medicare Part D coverage gap commonly referred to as "the doughnut hole." At this point, HIRSP covers prescription drug costs until catastrophic coverage begins under the Medicare Part D program.

Table 7

Net Claims Costs[1]
(in Millions)

Fiscal Year	Net Claims Costs[1]	Percentage Change
2000-01	$ 54.1	–
2001-02	67.2	24.2%
2002-03	85.8	27.7
2003-04	103.9	21.1
2004-05	130.4	25.5
2005-06	128.9	(1.2)

[1] Net of health care providers' contributions

Prescription drug cost savings were also achieved through a change in HIRSP's prescription drug formulary and increased rebates implemented when a new pharmacy benefit management company began administering the HIRSP prescription drug benefit in April 2005. HIRSP received $3.1 million in rebates in FY 2005-06, or $1.1 million more than was received in FY 2004-05.

Finally, shifts in enrollment from plan 1A to plan 1B contributed to more stable medical costs during FY 2005-06. In the last quarter of FY 2005-06, plan 1A costs were $1,080 per member per month. Plan 1B costs were $546 per member per month. We note that plan 1A has a deductible of $1,000 for medical costs, and plan 1B has a deductible of $2,500. Only 13.0 percent of plan 1B policyholders met their deductibles in calendar year 2005, while 39.6 percent of plan 1A policyholders met their deductibles.

Pending Legislative Changes

The HIRSP Authority is pursuing several statutory changes that are currently pending in the Legislature. 2007 Senate Bill 226/Assembly Bill 445 and subsequent amendments include recommended changes that would:

- allow prescription drugs to be provided by a network of pharmacists and pharmacies approved by the HIRSP Authority's Board regardless of whether they are certified to provide prescription drugs under the Medicaid program, as currently required;

- require that payments to providers consist of usual and customary payment rates as determined by the HIRSP Authority, with adjustments that take into account provider contributions. Currently, payment rates are based on Medicaid rates.

- make all policyholders with incomes below specified levels eligible for the premium and deductible subsidies. Currently, eligibility for the subsidies varies by plan option.

- change the determination of premium subsidies from a percentage of standard risk rates to a discount that reduces the unsubsidized premium rate by a specified percentage based on income level;

- repeal the statutory requirement that the HIRSP Authority design and administer a separate federally qualified program of health care coverage under which an individual could receive a federal income tax reduction under the federal health care tax credit program. The HIRSP Authority determined that such a program would not be economically feasible as a stand-alone program.

- allow the HIRSP Authority's Board, with the approval of the Commissioner of Insurance, to specify types of employer-provided health care coverage that do not render a person ineligible for coverage under HIRSP;

- require the State of Wisconsin Investment Board, if requested by the HIRSP Authority, to invest funds of the Authority in the State Investment Fund; and

- require that moneys received from insurer assessments and from federal grants be received directly by the Authority. Under current law, the funds are received by the Office of the Commissioner of Insurance and transferred to the Authority.

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Audit Opinion ■

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

We have audited the accompanying financial statements of the Wisconsin Health Insurance Risk-Sharing Plan (HIRSP) as of and for the years ended June 30, 2006 and 2005, as listed in the table of contents. 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of HIRSP as of June 30, 2006 and 2005, 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.

Our audits were conducted for the purpose of forming an opinion on the financial statements of HIRSP. The supplementary information included as Management's Discussion and Analysis on pages 25 through 32 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 September 10, 2007, on our consideration of HIRSP's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

LEGISLATIVE AUDIT BUREAU

September 10, 2007

Diann Allsen
Audit Director

Management's Discussion and Analysis ■

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

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

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

2005 Wisconsin Act 74, enacted December 21, 2005, created the HIRSP Authority. Effective July 1, 2006 administration of HIRSP was transferred to the Authority. More information on this change is included later in this discussion.

Overview of Financial Statements

HIRSP prepares its financial statements in accordance with Governmental Accounting Standards Board (GASB) standards.

HIRSP's financial statements comprise two components: 1) the financial statements, and 2) notes to 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 liabilities of HIRSP, with the differences between the two reported as net assets. Over time, increases or decreases in net assets are an indicator of HIRSP's financial health.

- The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and the expenses incurred during the year on an accrual basis.

- The Statement of Cash Flows presents information related to cash inflows and outflows summarized by operating 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 2005-06 and FY 2004-05, the plan had two funding types: program revenue in the form of segregated (SEG) funds, and federal grant funds.

Program revenue is received by HIRSP from policyholders and insurers. Health care providers, except pharmacies, contribute to HIRSP by accepting a reduction in fees for their services. Section 149.143, Wis. Stats., prescribes a funding formula for HIRSP that requires policyholders, private health insurers, and health care providers to share in plan costs. Through FY 2005-06, pharmacies were specifically exempt from contributing to HIRSP as provided by s. 149.142(1)(b), Wis. Stats.

Premiums were statutorily required, through FY 2005-06, to be at least 140 percent of standard risk rates, and are required by statute to fund 60 percent of estimated program 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 (except pharmacies) providing medical services to HIRSP policyholders are to share equally in:

- costs remaining after the deduction of the policyholders' share of the costs;

- premium, deductible, and drug coinsurance subsidy costs; and

- excess costs when premium rates needed to fund 60 percent of costs exceed 200 percent of premium rates for standard risks.

Financial Analysis of HIRSP

In this discussion and analysis, the reasons for the changes in financial activity between FY 2005-06 and FY 2004-05 and between FY 2004-05 and FY 2003-04 are reviewed. Net assets may serve over time as a useful indicator of the financial position of HIRSP. In the case of HIRSP, assets exceeded liabilities by $9,248,546 at the close of the fiscal year ending June 30, 2005, a decrease of $7,649,828 in net assets since June 30, 2004. Assets exceeded liabilities by $23,401,760 at the close of the fiscal year ending June 30, 2006, an increase of $14,153,214 in net assets since June 30, 2005.

Condensed Financial Information

	June 30, 2006	Percentage Change	June 30, 2005	Percentage Change	June 30, 2004
Total Assets	$56,340,452	10.6%	$50,953,750	(1.7)%	$51,820,029
Total Liabilities	32,938,692	(21.0)	41,705,204	19.4	34,921,655
Net Assets:					
Restricted	19,486,586	104.2	9,542,625	(5.6)	10,106,007
Unrestricted	3,915,174	1,431.3	(294,079)	(104.3)	6,792,367
Total Net Assets	**$23,401,760**		**$ 9,248,546**		**$16,898,374**

	FY 2005-06	Percentage Change	FY 2004-05	Percentage Change	FY 2003-04
Operating Revenues	$145,560,441	16.3%	$125,172,464	7.9%	$116,000,161
Operating Expenses	(135,873,529)	(0.1)	(136,023,918)	24.8	(109,033,117)
Nonoperating Revenues and Expenses	4,466,302	39.5	3,201,626	698.8	400,809
Change in Net Assets	**$ 14,153,214**		**$ (7,649,828)**		**$ 7,367,853**

The largest portion of HIRSP's total assets, 95.3 percent at June 30, 2005, and 94.8 percent at June 30, 2006, is in the form of cash and cash equivalents. HIRSP uses cash to pay current operating expenses. Cash in excess of immediate needs was invested in short-term investments with the State of Wisconsin Investment Board during FY 2004-05 and FY 2005-06.

The largest area of HIRSP's liabilities, 57.0 percent at June 30, 2005, and 51.5 percent at June 30, 2006, is unpaid loss liabilities. Unpaid loss liabilities represent the accumulation of unpaid medical and pharmaceutical claims, net of health care provider contributions, that were reported but not paid prior to the close of the accounting period, and an actuarial estimate of claims incurred prior to June 30 but not reported. Consequently, cash is reserved for payment of these future claims.

Unearned premiums comprise the second-largest liability, accounting for 40.3 percent at June 30, 2005, and 45.8 percent of liabilities at June 30, 2006. Unearned premiums are premiums paid in advance of the period of HIRSP coverage.

HIRSP's revenues consist of policyholder premiums, insurer assessments, and federal grant funds. HIRSP uses these revenues to pay operating expenses. HIRSP's revenues, combined with reduced payments to health care providers (provider contributions), were insufficient to cover all operating expenses during FY 2004-05 but were sufficient to cover expenses during FY 2005-06. HIRSP's net assets decreased by $7,649,828 during FY 2004-05 but increased by $14,153,214 during FY 2005-06, providing for a net increase of $6,503,386 over the two-year period.

Financial Highlights

- Plan enrollment as of June 30, 2005, was 19,385, an increase of 5.4 percent over June 30, 2004 enrollment of 18,395. Enrollment decreased 3.8 percent during FY 2005-06 to reach 18,650 as of June 30, 2006. Enrollment has continued to decline since June 30, 2006, and as of June 30, 2007, it was 17,612. The primary cause of the decline is a 32.0 percent decrease in plan 2 enrollment from 1,702 on June 30, 2005, to 1,157 as of June 30, 2006. Enrollment in that plan has continued to drop and as of June 30, 2007, was 945. The decline in plan 2 enrollment is attributed to the implementation of Medicare Part D.

- Policyholder premium revenue increased 15.1 percent during FY 2004-05 and 15.0 percent during FY 2005-06, due to aggregate premium rate increases among all plans of 12.8 percent during FY 2004-05 and 15.5 percent during FY 2005-06.

- Insurer assessment revenue decreased 8.3 percent during FY 2004-05 because $2.8 million of the insurers' net asset balance was carried forward from the prior calendar year. Insurer assessment revenue increased 19.8 percent during FY 2005-06 due to expected increases in program costs that were considered during the annual budget process when assessments are established.

- For both FY 2004-05 and FY 2005-06, federal grant funds were available for states that had established qualified high-risk pools that incurred losses (defined as premium revenue less operating expenses) and that restrict premiums charged to no more than 200 percent of premiums for standard risk rates, offer a choice of two or more coverage options, and have a mechanism in effect to reasonably ensure continued funding of losses incurred in connection with operation of the pool. HIRSP received $2.2 million in federal grant funds during FY 2004-05 and $2.5 million during FY 2005-06.

- Investment income increased from $406,299 in FY 2003-04 to $983,259 in FY 2004-05, and to $1,971,278 in FY 2005-06, due to an increased investment balance and an increase in interest rates.

- Total claims expenses (net of health care providers' contributions) increased 25.5 percent during FY 2004-05 due to increases in medical and pharmacy costs, utilization of services, and enrollment. However, claims expenses decreased 1.2 percent during FY 2005-06, largely because prescription drug costs decreased by 4.4 percent. The decrease in prescription drug costs, which account for 34.0 percent of FY 2005-06 total claims costs, is attributed to decreased enrollment in plan 2, which generally incurred higher prescription drug costs than the other plans. As of May 15, 2006, plan 2 policyholders are required to be enrolled in Medicare Part D, which is the first payer of prescription drug costs for those policyholders. Finally, rebate revenues that reduce prescription drug costs increased 53.9 percent, from $2.0 million in FY 2004-05 to $3.1 million in FY 2005-06. Corresponding to these changes in claims costs, unpaid loss liabilities increased by 35.1 percent in FY 2004-05 and decreased by 28.7 percent in FY 2005-06.

- Plan operations were conducted by DHFS staff, as well as a third-party contract administrator.

    - Total administrative costs were $5,509,742, or 4.1 percent of total plan costs, for FY 2004-05 and $6,765,221, or 4.9 percent of total plan costs, for FY 2005-06.

    - The following chart shows plan costs for claims and administrative expenses on a per member per month (PMPM) basis:

Cost Summary on a per Member per Month (PMPM) Basis
FY 2004-05 and FY 2005-06

Description	FY 2005-06	FY 2004-05	FY 2005-06 PMPM	FY 2004-05 PMPM	Percentage Change PMPM
Member Months (Total Members Enrolled in Each Month of Fiscal Year)	226,237	224,905	–	–	0.59%
Gross Claims (Costs before Provider Contributions Are Deducted)	$166,286,313	$162,056,142	$735.01	$720.55	2.01%
Administrative Expenses	$6,765,221	$5,509,742	$29.90	$24.50	22.04%

- HIRSP's net assets decreased by $7,649,828 during FY 2004-05, primarily as the result of HIRSP expenses being $3.1 million greater than budgeted and the use of $3.9 million of insurer and provider carryover asset balances to fund current costs. HIRSP's net assets increased by $14,153,214 during FY 2005-06, primarily as the result of HIRSP expenses being 16.3 percent less than budgeted. Lower enrollment, prescription drug costs, and medical cost trends contributed to the reduction in expenses. Increases were also reported in premium, assessment, provider contribution, and investment revenues.

- Net assets are split between restricted and unrestricted.

  - Restricted net assets, which represent policyholder premiums received in excess of their share of plan costs, decreased slightly during FY 2004-05, from $10,106,007 to $9,542,625, but increased significantly during FY 2005-06 to reach $19,486,586. The large increase in FY 2005-06 was the result of actual costs being less than projected in the budget. Further, premiums that had been set at minimum levels required by law increased an aggregate of 15.5 percent in FY 2005-06. Because the policyholders' share of costs was less than budgeted, the amount of premiums collected exceeded costs.

  - Through FY 2005-06, the restricted net assets were statutorily required under s. 149.143(2m)(b), Wis. Stats., to be used 1) to reduce policyholder premiums to a floor of 140 percent 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, which represent the insurers' and providers' portion of the fund balance, decreased during FY 2004-05 from $6,792,367 to ($294,079) but increased during FY 2005-06 to $3,915,174. A number of factors contributed to the decrease in FY 2004-05, including higher than estimated costs, the use of insurer and provider carryover balances, and a change in the usual and customary discount percentage. Lower than estimated expenses and a change in the usual and customary discount percentage contributed to the increase in FY 2005-06. Actual costs were 16.3 percent less than budgeted, leading to more revenues being collected than needed for each party's share of costs.

Other Known Facts

2005 Wisconsin Act 74, enacted in December 2005, made numerous changes to HIRSP, including the transfer of responsibility from DHFS to the newly created HIRSP Authority beginning July 1, 2006. Unencumbered balances in the DHFS appropriation accounts for HIRSP as of July 1, 2006, were transferred to the HIRSP Authority. As required under Act 74, the Authority continued to contract with the HIRSP plan administrator that had been under contract with DHFS. The Authority's Board of Directors was appointed in time to assist DHFS with transition functions. The Board selected and approved the hiring of a HIRSP director in June 2006. After assisting in the transition of HIRSP to the Authority, DHFS is no longer responsible for HIRSP. For additional details of the changes required by Act 74, see Note 12 of the financial statement notes.

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:

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

For questions concerning HIRSP activity after July 1, 2006, please contact:

HIRSP Authority
33 East Main Street, Suite 203
Madison, WI 53703

General information relating to HIRSP can be found at the HIRSP Web site, *http://www.hirsp.org*.

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Financial Statements ■

Balance Sheet
June 30, 2006 and 2005

	June 30, 2006	June 30, 2005
ASSETS		
Cash and Cash Equivalents (Note 2)	$ 53,429,712	$ 48,557,364
Drug Rebates Receivable (Note 3)	2,404,692	1,586,548
Premiums Receivable (Note 3)	244,827	528,125
Claims Receivable (Note 3)	258,836	192,835
Assessments Receivable	55	85,013
Prepaid Items	876	3,585
Due from the State of Wisconsin	1,454	280
TOTAL ASSETS	**$ 56,340,452**	**$ 50,953,750**
LIABILITIES AND NET ASSETS		
Liabilities:		
Unpaid medical loss liabilities (Note 4)	$ 14,104,277	$ 20,085,992
Unpaid pharmacy loss liabilities (Note 4)	557,423	1,293,902
Unpaid loss adjustment expenses (Note 4)	770,000	660,000
Unearned premiums (Note 1F)	15,091,792	16,817,952
Payments to providers (Note 3)	1,530,758	1,739,431
Miscellaneous payables	86,182	571,695
Accrued administrative expenses	798,260	536,232
Total Liabilities	**32,938,692**	**41,705,204**
Net Assets:		
Restricted for excess policyholder premiums (Note 5)	19,486,586	9,542,625
Unrestricted	3,915,174	(294,079)
Total Net Assets	**23,401,760**	**9,248,546**
TOTAL LIABILITIES AND NET ASSETS	**$ 56,340,452**	**$ 50,953,750**

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, 2006 and 2005

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
OPERATING REVENUES		
Premiums (Note 1F)	$ 106,680,929	$ 92,726,195
Insurers' Assessments (Note 6)	38,879,512	32,446,269
Total Operating Revenues	**145,560,441**	**125,172,464**
OPERATING EXPENSES		
Losses:		
Gross medical losses	130,670,856	109,839,286
Provider contributions (Note 10)	(37,361,435)	(31,626,631)
Increase (Decrease) in unpaid medical losses (Note 4)	(8,163,537)	6,436,550
Total medical losses	85,145,884	84,649,205
Gross pharmacy losses	44,515,473	46,131,112
Increase (Decrease) in unpaid pharmacy losses (Note 4)	(736,479)	(350,806)
Total pharmacy losses	43,778,994	45,780,306
Total Losses	**128,924,878**	**130,429,511**
Loss Adjustment Expenses (Note 4)	110,000	0
General and Administrative Expenses (Note 9)	6,765,221	5,509,742
Referral Fees (Note 1G)	73,430	84,665
Total Operating Expenses	**135,873,529**	**136,023,918**
OPERATING INCOME	**9,686,912**	**(10,851,454)**
NONOPERATING REVENUES AND EXPENSES		
Federal Grant Revenue (Note 11)	2,500,578	2,222,903
Investment Income	1,971,278	983,259
Transfer to the General Fund	(5,595)	(4,536)
Miscellaneous Revenue	41	0
Total Nonoperating Income	**4,466,302**	**3,201,626**
CHANGE IN NET ASSETS	**14,153,214**	**(7,649,828)**
NET ASSETS		
Total Net Assets—Beginning of the Year	9,248,546	16,898,374
Total Net Assets—End of the Year	**$ 23,401,760**	**$ 9,248,546**

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2006 and 2005

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received for Premiums	$ 105,248,746	$ 93,329,519
Cash Received for Assessments	38,967,747	32,451,804
Cash Received for Federal Grant	2,500,578	2,222,903
Cash Received for Miscellaneous Revenue	41	0
Cash Payments for Medical Losses	(91,270,306)	(79,896,477)
Cash Payments for Pharmacy Losses	(45,584,928)	(45,036,987)
Cash Payments for Other Expenses	(6,960,808)	(5,321,285)
Net Cash Provided by Operating Activities	**2,901,070**	**(2,250,523)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Income	1,971,278	983,259
Net Cash Provided by Investing Activities	**1,971,278**	**983,259**
NET INCREASE IN CASH AND CASH EQUIVALENTS	**4,872,348**	**(1,267,264)**
Cash and Cash Equivalents, Beginning of Year	48,557,364	49,824,628
Cash and Cash Equivalents, End of Year	$ 53,429,712	$ 48,557,364
RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net Operating Income	$ 9,686,912	$ (10,851,454)
Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities:		
Federal grant revenue reported as nonoperating revenue	2,500,578	2,222,903
Changes in assets and liabilities:		
Decrease (Increase) in receivables	(517,062)	(428,412)
Decrease (Increase) in prepaids	2,709	27,428
Increase (Decrease) in accounts payable	(113,487)	350,656
Increase (Decrease) in unearned premiums	(1,726,159)	252,542
Increase (Decrease) in medical loss liabilities	(5,981,715)	4,791,725
Increase (Decrease) in pharmacy loss liabilities	(945,152)	1,388,625
Other adjustments	(5,554)	(4,536)
Total Adjustments	(6,785,842)	8,600,931
Net Cash Provided by Operating Activities	**$ 2,901,070**	**$ (2,250,523)**

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's Office of the Commissioner of Insurance to the State of Wisconsin's 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. Plan 1A and plan 1B premiums, which were statutorily required to be at least 140 percent of standard-risk rates through FY 2005-06, 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. Through FY 2005-06, plan 2 premiums were established using criteria outlined in s. 149.14(5m), Wis. Stats.: 1) comparison of cost per capita for plans 1A and 2 in the previous calendar year; 2) enrollment levels of eligible persons in plans 1A and 2; and 3) economic factors that DHFS and the HIRSP 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 the policyholders' share of the costs;
- premium, deductible, and drug coinsurance subsidy costs; 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, such as investment income and federal grants, and nonoperating expenses are indirectly related to the ongoing medical insurance activities of HIRSP.

C. Accounting Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates. Estimates that are particularly susceptible to significant change are the unpaid loss liabilities as described in Notes 1E and 4 and the health care provider contributions 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 of Wisconsin, where available balances beyond immediate needs were

pooled in the State Investment Fund for short-term investment purposes. Balances pooled are restricted to legally stipulated investments. These investments are valued consistent with GASB Statement Number 31, *Accounting and Financial Reporting for Investments and for External Investment Pools.*

E. Unpaid Loss Liabilities

Unpaid loss liabilities represent the accumulation of losses 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, which are reported net of estimated health care provider discounts, 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 revenue 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 annually, and revenue is recognized over the period covered by the assessment. Insurer assessments are determined during the annual budgeting process.

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

HIRSP's cash balances were maintained primarily with the State of Wisconsin Investment Board, with a small balance maintained in a state bank account. In FY 2004-05, general depository and claims checking accounts were also maintained with a commercial financial institution. Cash was transferred between the commercial accounts and the state account as necessary. The carrying amount of the commercial accounts was $1,031,054 as of June 30, 2005, and the bank balance was $1,033,870 as of June 30, 2005.

In FY 2005-06, zero-balance state-controlled depository and claims checking accounts were used in conjunction with the primary HIRSP state bank account. HIRSP deposits were transferred daily from the depository account to the primary account, and cash was transferred from the primary account to the claims account to cover checks clearing that day. The carrying amount of the primary HIRSP account was $1,468,983 as of June 30, 2006, and the bank balance was $1,419,427. An additional $49,556 in cash was being held in the custody of the HIRSP plan administrator.

Custodial credit risk related to deposits is the risk that in the event of the failure of a depository financial institution, HIRSP will not be able to recover deposits that are in possession of an outside party. DHFS did not have a deposit policy specifically for custodial credit risk related to HIRSP. The Federal Deposit Insurance Corporation and a state appropriation for losses on public deposits, s. 34.08, Wis. Stats., insure state deposits up to $500,000. Therefore, $919,427 of the bank balance was uninsured and uncollateralized at June 30, 2006, and $533,870 was uninsured and uncollateralized at June 30, 2005.

Cash deposited with the State of Wisconsin was invested in the State Investment Fund, which is a short-term pool of state and local funds managed by the State of Wisconsin Investment Board with oversight by its Board of Trustees. The carrying amount of shares in the State Investment Fund, which is presented at fair value, was $51,960,729 as of June 30, 2006, and $46,370,607 as of June 30, 2005. Cash on deposit with the State but not yet invested in the State Investment Fund was $1,419,427 as of June 30, 2006, and $1,155,703 as of June 30, 2005.

The various types of securities in which the State Investment Fund may invest are enumerated in ss. 25.17(3)(b), (ba), and (bd), Wis. Stats., and include direct obligations of the United States and Canada, securities guaranteed by the United States, securities of federally chartered corporations, unsecured notes of financial and industrial issuers, Yankee/Euro issues, certificates of deposit issued by banks in the United States and solvent financial institutions in this state, and bankers' acceptances. The State of Wisconsin Investment Board's trustees may approve other prudent investments and have granted derivatives authority, subject to review and approval by the State of Wisconsin Investment Board's Investment Committee, limited to positions in finance futures, options, and swaps and only if the purpose is to hedge existing positions, adjust portfolio duration within statutory guidelines, or reduce the interest rate risk. Interest only and principle only securities, inverse floaters, and off–balance sheet synthetic derivates are not permitted. The State Investment Fund is not registered with the Securities and Exchange Commission.

3. RECEIVABLES AND PAYABLES

Unless otherwise noted, receivable balances are expected to be collected within the following year. While the plan expects to receive all drug rebates receivable, it typically takes more than one year for final settlement to occur.

Premiums receivable included $118,288 at June 30, 2006, and $204,344 at June 30, 2005, that were due from the plan administrator for premium payments made by credit card and not yet transferred to HIRSP. The remaining premiums receivable of $126,539 as of June 30, 2006, and $323,781 as of June 30, 2005, was unreserved premium payments due for the subsequent July premium period.

The June 30, 2006 balance of unreserved claims receivables of $258,836 is less than 18 months old, and the June 30, 2005 balance of $192,835 is less than one-year old.

A large payable to providers existed at June 30, 2006, and June 30, 2005, because of the timing of the last June bimonthly pharmacy claims payment. The remaining outstanding claims are included in the unpaid loss liabilities account (see Note 4).

4. LIABILITY FOR UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

The following represents changes in the combined medical and pharmacy unpaid loss liabilities and unpaid loss adjustment expense liability account balances for FYs 2005-06 and 2004-05 (in thousands):

	FY 2005-06	FY 2004-05
Balance—Beginning of the Year	$ 22,040	$ 17,599
Incurred Claims:		
Provision for insured events of the current fiscal year	138,050	134,979
Changes in provision for insured events of prior fiscal years	(5,468)	(1,092)
Total Incurred	132,582	133,887
Payments:		
Claims attributable to insured events of the fiscal year	123,970	113,955
Claims attributable to insured events of prior fiscal years	15,220	15,491
Total Paid	139,190	129,446
Balance—End of the Year	$ 15,432	$ 22,040

5. NET ASSETS RESTRICTED FOR EXCESS POLICYHOLDER PREMIUMS

Through FY 2005-06, s. 149.143(2m)(a), Wis. Stats., required DHFS to keep a separate accounting of the difference between premiums received during a plan year and the amount of premiums necessary to cover policyholders' 60 percent share of plan costs for that plan year. The use of these funds was restricted under s. 149.143(2m)(b), Wis. Stats., as follows: 1) to reduce policyholder premiums to a floor of 140 percent of standard-risk rates when the policyholders' share of costs would otherwise require a premium increase; 2) for other needs of eligible persons, with the approval of the HIRSP Board of Governors; or 3) for distribution to eligible persons.

Under statutes, the method by which HIRSP's funding formula applied deductible and drug coinsurance subsidies for low-income policyholders resulted in policyholders being credited for subsidies that were not funded by policyholders nor insurers nor providers. In July 2005, the Board of Governors voted to use $1,100,225 of the excess policyholder premium account to reduce the unfunded deductible and drug coinsurance subsidies balance as of June 30, 2005. During FY 2005-06, an additional $1,008,123 of unfunded deductible and coinsurance subsidies balance had accumulated. As part of the annual budgeting process, the Board of Governors voted to use $1,008,123 of the excess policyholder premium account to reduce the balance as of June 30, 2006. 2005 Wisconsin Act 74 simplified the statutory funding formula for HIRSP and addressed this technical statutory provision effective July 1, 2006.

6. INSURERS' ASSESSMENTS

Statutes prescribe that participating insurers contribute 20 percent of general HIRSP costs and 50 percent of the subsidy costs. Each participating insurer shares in the costs of HIRSP in proportion to the ratio of that 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 annually.

7. DRUG COINSURANCE ANNUAL OUT-OF-POCKET MAXIMUMS

The drug coinsurance benefit 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 drug coinsurance subsidies provided in FY 2005-06 and FY 2004-05.

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

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

8. PREMIUM, DEDUCTIBLE, AND DRUG COINSURANCE SUBSIDIES

HIRSP provides a premium, deductible, and drug coinsurance subsidy program to reduce premiums, deductible levels, and out-of-pocket costs for prescription drugs for low-income policyholders. This program varies by plan and option. HIRSP policyholders enrolled in plan 1A or plan 2 who have annual household incomes below $25,000 are eligible for a premium subsidy. No premium subsidy is available for policyholders enrolled in plan 1B. Policyholders enrolled in plan 1A with incomes below $20,000 are also eligible for a deductible subsidy. No deductible subsidy is available for policyholders enrolled in plan 1B or plan 2. Note 7 further discusses the drug coinsurance subsidies that are also provided to plan 1A policyholders.

HIRSP premiums for plans 1A and 1B are based on standard risk rates; that is, the rates private insurers would charge for individual insurance policies providing substantially the same coverage and deductibles as provided under HIRSP. Policyholders not eligible for a premium subsidy have generally been paying 140 to 150 percent of the rate a standard-risk individual 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. Premium rates for the primary plan were set at 143.6 percent of the rate a standard-risk individual would pay in FY 2005-06, and at 140.0 percent in FY 2004-05.

Policyholders enrolled in plan 1A or plan 2 who are eligible for the subsidy program pay premiums indexed to the standard-risk rates, as shown in the following table.

Annual Household Income at Least	but Less Than	Amount of Premium as Percentage of Standard-Risk Rates	Reduction in Deductible for Plan 1A Participants
$ 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

Eighteen percent of HIRSP policyholders received premium, deductible, and drug coinsurance subsidies totaling $6,000,207 in FY 2005-06, and 20.0 percent received subsidies totaling $5,018,627 in FY 2004-05. The following table summarizes the amounts provided for each subsidy type during these years.

Subsidy Type	FY 2005-06	FY 2004-05
Premium	$4,992,085	$4,142,096
Deductible	666,287	660,248
Drug Coinsurance	341,835	216,283
Total	$6,000,207	$5,018,627

Premium, deductible, and drug co-insurance subsidy costs were shared equally by health insurers and health care providers, with each contributing $3,000,103 in FY 2005-06, and $2,509,314 in FY 2004-05. Pharmacies were statutorily exempt from contributing toward these costs through FY 2005-06.

9. GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses include the following:

	FY 2005-06	FY 2004-05
Plan Administrator Fees	$6,090,047	$4,826,220
Plan Administrator Change Orders	226,317	0
State Administrative Costs	392,596	483,072
Other Expenses	30,425	49,874
Transition to Authority	25,836	0
Postage	0	150,576
Total	$6,765,221	$5,509,742

DHFS, in consultation with HIRSP's Board of Governors, selected a new HIRSP plan administrator through a competitive procurement process. The new plan administrator, Wisconsin Physicians Service (WPS), has subcontracted with Navitus Health Solutions for pharmacy benefit management services and with Milliman USA for consulting actuarial services. The plan administrator's operations period began April 1, 2005, and ends April 1, 2008, with three one-year renewals possible. Plan administrator change orders in FY 2005-06 represent one-time costs to establish HIRSP as a State Pharmaceutical Assistance Program and to implement changes to plan 2 related to Medicare Part D. Plan administrator fees for FY 2004-05 include one-time transition costs of $199,000. Beginning April 1, 2005, postage costs are included in plan administrator fees. Therefore, only nine months of postage expense is included in the amount presented for FY 2004-05.

10. HEALTH CARE PROVIDERS' CONTRIBUTIONS

Statutes prescribe that health care providers, except pharmacies, contribute 20 percent of general HIRSP costs and 50 percent of the subsidy costs. Provider contributions are obtained by reducing the amount health care providers are reimbursed for billed services. The health care provider contributions are not reported as revenue in the financial statements, but rather are reflected as a reduction to gross losses.

The basis for calculating HIRSP's program costs is usual and customary charges, which are reported as medical losses in the financial statements. The usual and customary charges are determined by applying percentage discounts to billed charges. From 1998 until 2003, the discounts used were based on reimbursement levels under the HIRSP program prior to 1998. The provider contribution represents the difference between usual and customary charges and allowed charges, which are amounts based on Medicaid reimbursement rates plus an add-on percentage.

In 2004, usual and customary charges, the provider contribution balance, and program costs began to grow considerably. An actuarial analysis determined the cause to be an increase in billed charges and provider reimbursement rates not keeping pace with inflation. The HIRSP discount in place since 1998 was believed to be approximately 10 percent lower than the industry average. Based on the difference between HIRSP discounts and estimated industry averages, the Board of Governors decided in January 2005 to increase the discounts applied to billed charges for the period January 1, 2004 through June 30, 2005, to be more reflective of industry averages. On an aggregate basis, the discounts were increased from approximately 20 percent to approximately 30 percent. The revised discounts are reflected in the medical losses reported for FY 2004-05. The revised discounts decreased program costs that are shared by the different funding groups but did not affect the net losses paid.

To further analyze growing provider contributions and program costs, the Board convened its actuarial advisory subcommittee to provide advice on establishing a market-based benchmark for determining usual and customary charges in the future. After obtaining input from the HIRSP contracted actuary and the subcommittee, the Board also concluded that the increasing provider contributions and program costs were the result of several factors, including increasing charges billed by providers and provider rates not keeping pace with inflation. The Board approved a 28.5 percent discount rate to billed charges for all non-pharmacy providers beginning July 1, 2005. In addition, provider reimbursement rates were increased 2.0 percent beginning July 1, 2005.

Although management believes the results of the estimates are materially correct, uncertainties inherent in estimates may result in the actual provider contribution exceeding or being less than the amounts estimated.

11. FEDERAL GRANT REVENUE

DHFS applied for and received federal grants designated specifically for high-risk health insurance pools. The grant funds, which were first available to HIRSP in FY 2004-05, were used to pay HIRSP claims and reduced program costs for the three funding parties. On behalf of the HIRSP Authority, DHFS applied for the same grant for FY 2006-07, and grant funds of $4,422,935 were awarded in September 2006. These funds will be reflected in the FY 2006-07 financial statements.

12. SUBSEQUENT EVENTS

2005 Wisconsin Act 74, which was enacted December 21, 2005, made significant changes to HIRSP. It created the HIRSP Authority and transferred administrative authority from DHFS to the new Authority and its Board of Directors effective July 1, 2006. An Authority is a public body, created by law, with a board of directors, but it is not a state agency. Act 74 specifies the composition of the Board of Directors and defines the duties and powers of the Authority, which is subject to open records and open meetings requirements of ch. 19, Wis. Stats. The Authority is to adopt policies to administer HIRSP according to ch. 149, Wis. Stats., and to contract with the current plan administrator for HIRSP. Under Act 74, unencumbered balances in the DHFS appropriation accounts for HIRSP as of July 1, 2006, were transferred to the HIRSP Authority.

In addition to administrative authority being transferred to the HIRSP Authority, a number of other provisions of 2005 Wisconsin Act 74 also took effect after FY 2005-06. Specifically, the Act:

- eliminated the complex funding formula under prior law, but retains the same basic funding system that premiums must pay 60 percent of costs, excluding subsidies, and insurers and providers must each pay 20 percent of costs excluding subsidies;

- requires that subsidy costs be paid first from any federal funds received and then equally by insurers and providers;

- requires the Legislative Audit Bureau to annually conduct a financial audit of HIRSP;

- continued HIRSP benefits under prior law through December 31, 2006. Beginning January 1, 2007, HIRSP benefits may be changed, subject to the requirement that certain services specified in statutes be covered.

- requires that HIRSP applicants be domiciled in Wisconsin for three months instead of 30 days, as under prior law;

- requires applicants be rejected by two insurers instead of one insurer within nine months;

- retains provisions in prior law that persons with low household incomes receive premium subsidies as established by the Authority;

- requires the Authority to design and administer a qualified health plan under the federal Trade Adjustment Assistance Reform Act of 2002; and

- created an income and franchise tax credit and a license fee credit for insurers that pay HIRSP assessments.

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Report on Internal Control and Compliance ■

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

We have audited the financial statements of the Wisconsin Health Insurance Risk-Sharing Plan (HIRSP) as of and for the years ended June 30, 2006, and June 30, 2005, and have issued our report thereon dated September 10, 2007. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Department of Health and Family Services' 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 an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

The reportable condition noted was the failure by the Department and the plan administrator to implement Board of Governors–approved changes to usual and customary discounts to billed medical claims that were to take effect July 1, 2005.

As a result, program costs and provider contributions initially were not being properly calculated during FY 2005-06. After we informed the Department of the oversight, it agreed with our concerns and took steps to correct the error and ensure program costs and provider contributions were properly calculated. Further discussion of the reportable condition can be found in our prior-year's audit report (report 06-10).

A material weakness is a reportable 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 caused by error or fraud in amounts that would be material in relation to the basic 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable condition related to the failure to implement changes to usual and customary discounts to be a material weakness during FY 2004-05 and FY 2005-06.

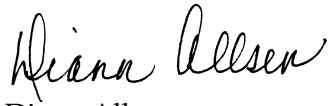
COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether HIRSP's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

However, we noted a certain additional matter, pertaining to immaterial nursing home claims errors by the plan administrator, that we reported to the HIRSP Authority in a separate memorandum dated August 27, 2007. Furthermore, we noted another matter, pertaining to the resolution and reporting of claims errors by the plan administrator, that we reported to the Department of Health and Family Services in a separate memorandum dated June 14, 2006.

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

LEGISLATIVE AUDIT BUREAU



September 10, 2007

Diann Allsen
Audit Director