

SAN FRANCISCO HEALTH SERVICE SYSTEM

Affordable, Quality Benefits & Well-Being

Memorandum

DATE: February 14, 2019
TO: Karen Breslin, President and Members of the Health Service Board
FROM: Pamela Levin, Chief Financial Officer
RE: Audited Financial Statements – June 30, 2018 and 2017

KPMG has completed the audit of the Health Service System Trust Fund (Trust) for the fiscal year (FY) ended June 30, 2018. The audit consisted of an examination of the financial status for FY 2017-18, a comparison of the changes between FY 2017-18 and FY 2016-17, and an analysis of internal controls. No deficiencies in internal controls and no instances of noncompliance were identified by the auditor.

Summary

The Trust ended FY 2017-18 with a balance of \$77.4 million in net assets (also known as net position). This was an increase of \$4.9 million from the balance of \$72.5 million as of June 30, 2017.

	Net Assets (in Millions)
Balance 6/30/2017	\$72.5
Change in Net Assets	\$4.9
Balance 6/30/2018	\$77.4

Changes in Net Assets

The \$4.9 million increase in net assets is primarily due to the following:

- \$6.1 million decrease in the City Health Plan net position due to use of the Claims Stabilization Reserve;
- \$5.6 million increase in the Blue Shield flex-funded plan net position was due to excess premium equivalents over claim costs of \$1.2 million, and use of claim stabilization funding, per HSB approved policy, of \$4.4 million;
- \$2.7 million increase in the dental plans net position was due to excess premium equivalents over claim costs of \$5.5 million offset by claim stabilization, per HSB approved policy, of \$2.8 million;
- \$0.9 million increase in Kaiser plan net position was based on contract premium arrangements for new enrollees, termed members, members eligible for Medicare, and members with changing contribution schedule;
- \$0.8 million increase in savings in the Healthcare Sustainability fund;
- \$0.2 million increase in flexible spending account employee contributions over claim reimbursements to participants; and
- \$0.8 million increase in the net position for interest income, performance guarantee penalties.

Future Obligations and Reserves

The Department worked with Aon to identify \$43.4 million in future obligations and reserves.

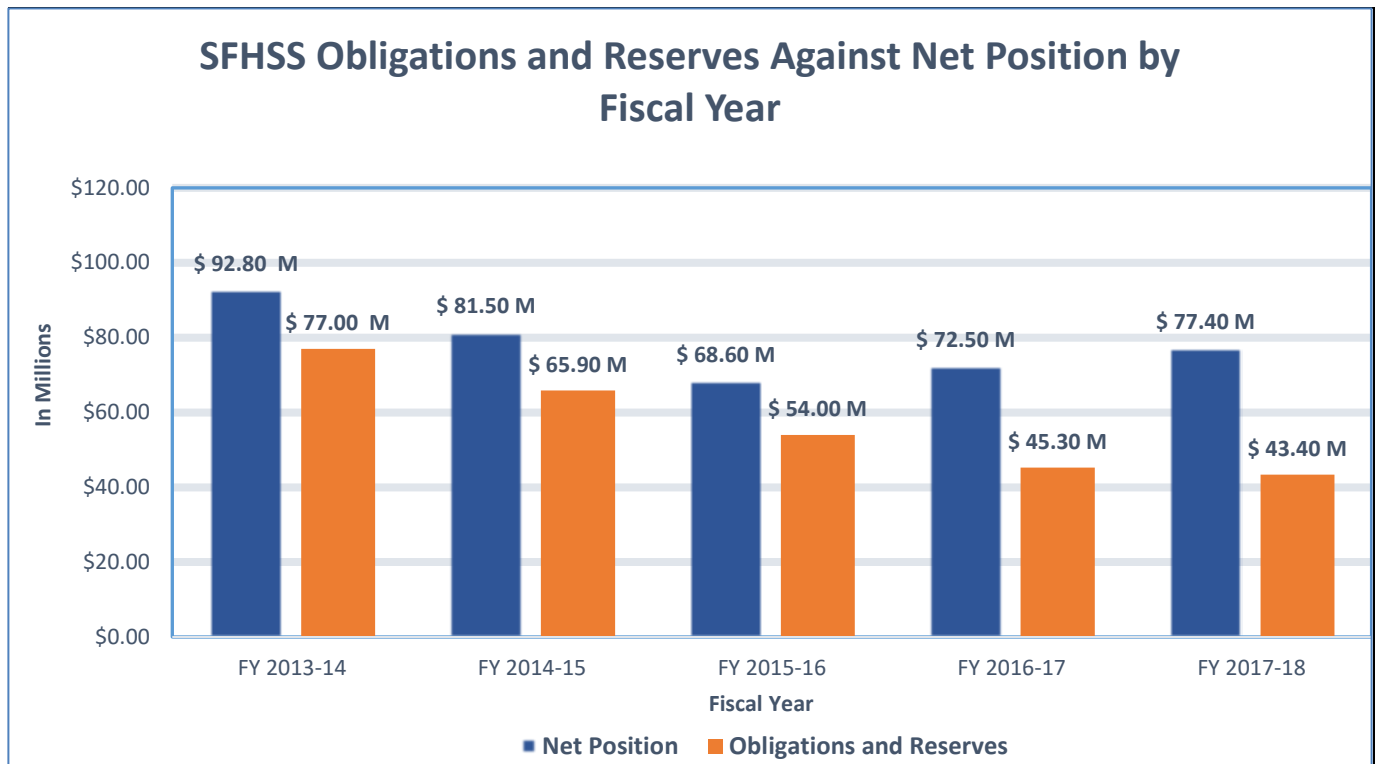
<u>FY 2018-19 Reserves and Obligations</u>		
	(in Millions)	Total
Net Assets as of 3/30/2018		\$77.4
Contingency Reserves ¹		
City Health Plan	\$5.9	
Blue Shield	14.1	
Delta Dental	<u>\$3.0</u>	\$23.0
Stabilization reserves ²		
<u>City Health Plan</u>		
Rate stabilization July – December 2018	\$2.3	
2019 Rate Stabilization	\$1.7	
Rate Stabilization 2020 and beyond	<u>\$0.0</u>	\$4.0
<u>Delta Dental</u>		
Rate Stabilization July – December 2018	\$1.6	
2019 Rate Stabilization	4.2	
Rate Stabilization 2020 and beyond	<u>\$8.5</u>	\$14.3
Healthcare Sustainability Fund		\$0.9
Performance Guarantees – Adoption and Surrogacy Benefit		
2019	\$0.3	
2020 – 2022	<u>\$0.9</u>	\$1.2
Total Obligations and Reserves		<u>\$43.4</u>
Net Assets Remaining After the 2019 Reserves and Obligations		\$34.0

¹ Contingency reserves absorb the risk of claims in excess of expected claims targets.

² Stabilization reserves are calculated based on financial gain or loss for Self-Funded and flex-funded plans amortized over a three (3) year rating period, for stabilization of rates.

Historical View of Net Position and Reserves and Obligations Against the Net Position

The following graph contrasts the net position at the end of each fiscal year and the reserves and obligations against it. For example, the net position at the end of FY 2017-18 is \$77.4 and the reserves and obligations against the \$77.4 are \$43.4 million. While the Trust's net position in FY 2017-18 is less than FY 2014-15, the obligations and reserves continue to decrease as the Stabilization Reserves have been utilized to buy-down rates pursuant to the Health Service Board's policies.



Year End Information

Disposition of Stabilization Reserves

Based on the Board's policies, underwriting gains and losses are allocated over a three-year period. As of December 31, 2017, the Stabilization Reserves totaled \$14.4 million. The Board authorized use of \$5.9 million during Rates and Benefit process for 2019 which leaves a balance of \$8.5 million for rate stabilization in future years. Aon will reevaluate the reserves at the beginning of the 2019 Rates and Benefit process during which the 2020 rates are determined. The disposition of the reserves are as follows:

<u>Stabilization Reserves</u>			
	Total Reserve	Amounts used for 2019 rates	Balance to be used for future years
City Health Plan reserves as of 12/31/2017	\$1.7	\$1.7*	\$0.0
Delta Dental reserves as of 12/31/2017	<u>\$12.7</u>	<u>\$4.2</u>	<u>\$8.5</u>
	\$14.4	\$5.9	\$8.5
<i>*Includes \$1.1 Million of City Health Plan reserves approved by the Board in June 2018 to lower active and early retiree premiums</i>			

Investment Earnings, Performance Guarantees, Forfeitures

The following table provides a high-level comparison of the investment earnings, performance guarantees and forfeitures for FY 2017-18 and FY 2016-17.

Investment Earnings, Performance Guarantees, Forfeitures		
<u>Category</u>	<u>FY 2017-18</u>	<u>FY 2016-17</u>
Net Change in Fair Value of Investments	(\$474,067)	(\$28,722)
Investment Earnings	1,190,759	474,095
Performance Guarantees	107,541	133,007
Forfeitures	<u>\$0</u>	<u>\$578,433</u>
Total	\$824,233	\$1,156,813

Investment Earnings

There are two categories of Investment Earnings on the Statement of Changes in Net Position - net increase (decrease) in fair value of investments and interest income. The FY 2017-18 Statement of Changes in Net Position shows:

<u>Investment earnings</u>	
Net (decrease) in fair value of investments	(\$474,067)
Interest Income	<u>1,190,759</u>
Total investment earnings as of 6/30/2018	\$716,692

In accordance with General Accounting Standards Board (GASB) Statement Number 31, Accounting and Financial Reporting for Certain Investments and External Investment Pools, the City must report, at the end of each fiscal year, certain investments at fair value in the Financial Statement. The City must also report the change in fair value of investments in the year in which the change occurred. In other words, the City is required to report the fair value of the Trust investments under the assumption that the City would stop doing business on June 30, 2018 and therefore would have to sell all the assets. As a practical matter, the City did not stop doing business on June 30, 2018. As such, the change in the fair value of investments should not be considered a reduction to the interest earnings.

Performance Guarantee Penalties

The following chart outlines the performance guarantee penalties received in FY 2017-18 and FY 2016-17.

<u>Performance Guarantees</u>		
<u>Plan Year</u>	<u>FY 2017-18</u>	<u>FY 2016-17</u>
2017	\$107,541	
2016	<u>0</u>	<u>\$133,007</u>
Total	\$107,541	\$ 133,007

Adoption and Surrogacy Assistance Plan

Adoption and Surrogacy Assistance Plan was introduced in January 2017 funded through performance guarantee penalties. Since inception of the program, a total \$185,936 has been paid for eight (8) adoptions and five (5) surrogacies.

Next Steps

KPMG issued the Trust’s Finance Statements as of June 30, 2018 with Independent Auditors’ Report on February 5, 2019. Hard copies are available at the SFHSS office (1145 Market, 3rd floor). The statements are also posted on myhss.org. The Comprehensive Annual Financial Report will contain a high-level summary of the Trust Fund.