

SAN FRANCISCO HEALTH SERVICE SYSTEM

Affordable, Quality Benefits & Well-Being

Memorandum

DATE: December 14, 2017
TO: Randy Scott, President and Members of the Health Service Board
FROM: Pamela Levin, Chief Financial Officer
RE: Audited Financial Statements – June 30, 2017 and 2016

KPMG has completed the audit of the Health Service System Trust Fund (Trust) for the fiscal year (FY) ended June 30, 2017. The audit consisted of an examination of the financial status for FY 2016-17, a comparison of the changes between FY 2016-17 and FY 2015-16, 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 2016-17 with a balance of \$72.5 million in net assets (also known as net position). This was an increase of \$3.9 million from the balance of \$68.6 million as of June 30, 2016.

| | Net Assets (in Millions) |
|----------------------|-----------------------------|
| Balance 6/30/2016 | \$68.6 |
| Change in Net Assets | <u>\$3.9</u> |
| Balance 6/30/2017 | \$72.5 |

Changes in Net Assets

The \$3.9 million increase in net assets is primarily due to the following:

- \$9.2 million decrease in the City Health Plan net position due to excess premium equivalents over claim cost of \$1.6 million, and claim stabilization of \$10.8 million;
- \$6.9 million increase in the Blue Shield flex-funded plan net position due to excess premium equivalents over claim costs of \$2.1 million, and claim stabilization of \$4.8 million;
- \$3.7 million increase in the dental plans net position due to excess premium equivalents over claim cost of \$5.5 million offset by claim stabilization of \$1.8 million;
- \$0.8 million increase in the net position for the Healthcare Sustainability Fund;
- \$0.5 million increase in the net position for flexible spending accounts due to the timing of contributions and claim reimbursements; and
- \$1.2 million increase in the net position for interest income, performance guarantee penalties, and forfeitures consisting of:

| <u>Change in Net Assets</u> | |
|---|---------------|
| | (In Millions) |
| Forfeitures | \$ 0.58 |
| Performance Guarantees | 0.13 |
| Net Change in Fair Value of Investments | (0.03) |
| Interest Income | <u>0.47</u> |
| Total | \$ 1.16 |

Future Obligations and Reserves

The Department worked with Aon to identify \$45.3 million in future obligations and reserves.

| <u>FY 2017-18 Reserves and Obligations</u> | | |
|--|---------------|---------------|
| | (in Millions) | Total |
| Contingency Reserves¹ | | |
| City Health Plan | \$5.6 | |
| Blue Shield | 13.3 | |
| Delta Dental | <u>\$3.1</u> | \$22.0 |
| Stabilization reserves² | | |
| <u>City Health Plan</u> | | |
| Rate stabilization July – December 2017 | \$3.8 | |
| 2018 Rate Stabilization | \$4.5 | |
| Rate Stabilization 2019 and beyond | <u>\$0.0</u> | \$8.3 |
| <u>Delta Dental</u> | | |
| Rate Stabilization July – December 2017 | \$1.2 | |
| 2018 Rate Stabilization | 3.2 | |
| Rate Stabilization 2019 and beyond | <u>\$6.4</u> | \$10.8 |
| Healthcare Sustainability Fund | | \$3.0 |
| Performance Guarantees – Adoption and Surrogacy Benefit | | |
| 2018 | \$0.3 | |
| 2019 – 2021 | <u>\$0.9</u> | \$1.2 |
| Total Obligations and Reserves | | \$45.3 |

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.

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 June 30, 2017, the Stabilization Reserves totaled \$14.1 million. The Board authorized use of \$7.7 million during Rates and Benefit process for 2018 which leaves a balance of \$6.4 million for rate stabilization in future years. Aon will reevaluate the reserves at the beginning of the 2018 Rates and Benefit process during which the 2019 rates are determined. The disposition of the reserves are as follows:

| <u>Stabilization Reserves</u> | | | |
|---|---------------|-----------------------------|-------------------------------------|
| | Total Reserve | Amounts used for 2018 rates | Balance to be used for future years |
| City Health Plan reserves as of 12/31/2016 | \$4.5 | \$4.5* | \$0.0 |
| Delta Dental reserves as of 12/31/2016 | <u>\$9.6</u> | <u>\$3.2</u> | <u>\$6.4</u> |
| | \$14.1 | \$7.7 | \$6.4 |
| <i>*Includes \$3.0 Million of City Health Plan reserves approved by the Board in June 2017 to lower active and early retiree premiums</i> | | | |

Investment Earnings, Performance Guarantees, Forfeitures

The following table provides a high comparison of the investment earnings, performance guarantees and forfeitures for FY 2016-17 and FY 2015-16.

| <u>Investment Earnings, Performance Guarantees, Forfeitures</u> | | |
|---|---------------------|---------------------|
| <u>Category</u> | <u>FY 2016-17</u> | <u>FY 2015-16</u> |
| Net Change in Fair Value of Investments | \$ (28,722) | \$ (48,423) |
| Investment Earnings | 474,095 | 381,399 |
| Performance Guarantees | 133,007 | 528,610 |
| Forfeitures | <u>\$ 578,433</u> | <u>\$315,162</u> |
| Total | <u>\$ 1,156,813</u> | <u>\$ 1,178,746</u> |

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 2016-17 Statement of Changes in Net Position shows:

| <u>Investment earnings</u> | |
|---|----------------|
| Net (decrease) in fair value of investments | (\$ 28,722) |
| Interest Income | <u>474,095</u> |
| Total investment earnings as of 6/30/2017 | \$445,373 |

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, 2017 and therefore would have to sell all the assets. As a practical matter, the City did not stop doing business on June 30, 2017. 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 2016-17 and FY 2015-16. It is important to note that the San Francisco Health Service (SFHSS) received penalties for one plan year in FY 2016-17 and two plan years in FY 2015-16.

| <u>Performance Guarantees</u> | | |
|-------------------------------|-------------------|-------------------|
| <u>Plan Year</u> | <u>FY 2016-17</u> | <u>FY 2015-16</u> |
| 2016 | \$133,007 | \$ 0 |
| 2015 | 0 | 305,166 |
| 2014 | <u>\$ 0</u> | <u>\$ 223,443</u> |
| Total | \$133,007 | \$ 528,610 |

Adoption and Surrogacy Assistance Plan

The payouts for the Adoption and Surrogacy Assistance Plan for FY 2016-17 are as follows. They are funded through performance guarantee penalties.

| <u>Adoption and Surrogacy Assistance Plan Payouts</u> | | | |
|---|----------------------|-------------------|-----------------------|
| <u>Type</u> | <u>Approval Date</u> | <u>FY 2016-17</u> | <u>FY 2017-18 YTD</u> |
| Adoption | April 26, 2017 | \$ 7,710 | N/A |
| Adoption | May 23, 2017 | 15,000 | N/A |
| Surrogacy | August 16, 2017 | N/A | 15,000 |
| Adoption | Pending | N/A | \$ 15,000 |
| Total | | \$ 22,710 | \$ 30,000 |

Next Steps

KPMG issued the Trust's Finance Statements as of June 30, 2017 with Independent Auditors' Report on October 20, 2017. 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, issued in December 2017, contains a high-level summary of the Trust Fund.