

**SAN FRANCISCO
HEALTH SERVICE SYSTEM**

Affordable, Quality Benefits & Well-Being

Memorandum

DATE: December 8, 2016
TO: Randy Scott, President and Members of the Health Service Board
FROM: Pamela Levin, Chief Financial Officer
RE: Audited Financial Statements – June 30, 2016 and 2015

KPMG has completed the audit of the Health Service System Trust Fund (Trust) for the fiscal year (FY) ended June 30, 2016. The audit consisted of an examination of the financial status for 2015-16, comparison of the changes between FY 2015-16 and FY 2014-15 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 2015-16 with a balance of \$68.6 million in net assets (also known as net position). This was a decrease of \$12.9 million from the balance of \$81.5 million as of June 30, 2015.

	Net Assets (in Millions)
Balance 6/30/2015	\$81.5
Change in Net Assets	\$(12.9)
Balance 6/30/2016	\$68.6

Changes in Net Assets

The \$12.9 million decrease in net assets is primarily due to:

- \$10.8 million decrease in the City Health Plan (excess claim costs over premium equivalents of \$0.1 million, and \$10.7 million in claim stabilization, per HSB approved policy)
- \$7.3 million decrease in the Blue Shield flex-funded plan (excess claim costs over premium equivalents of \$4.6 million, premium credit of \$4.4 million from the Blue Shield '2 Percent Profit Pledge' offset by claim stabilization, per HSB approved policy, of \$1.7 million)
- \$3.8 million increase in the dental plans (excess premium equivalents over claim cost of \$4.4 million offset by claim stabilization, per HSB approved policy, of \$0.6 million)
- \$0.2 million increase in Blue Shield fully insured and Kaiser plans from contract premium arrangements for new enrollees, termed members, and members eligible for Medicare

- \$0.2 million increase in administrative savings in the Healthcare Sustainability Fund
- \$0.2 million decrease in flexible spending account contributions over claim reimbursements
- \$1.2 million increase in Trust Fund interest income, performance guarantee penalties, and forfeitures

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 2015-16 Statement of Changes in Net Position shows:

Investment earnings:	
Net (decrease) in fair value of investments	(\$48,423)
Interest Income	<u>\$381,399</u>
Total investment earnings as of 6/30/2016	\$332,976

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 what the fair value of HSS's investments under the assumption that the City would stop doing business on June 30, 2016 and therefore would have to sell all the assets. As a practical matter, the City did not close down on June 30, 2016 so the change in the fair value of investments should not be considered a reduction to the interest earnings.

Future Obligations and Reserves

The Department worked with Aon to identify \$54.0 million in future obligations and reserves.

<u>FY 2016-17 Reserves and Obligations</u>		
	(in Millions)	Total
Contingency Reserves ¹		
City Health Plan	\$5.7	
Blue Shield	15.1	
Delta Dental	\$3.6	\$24.4
Stabilization reserves ²		
<u>City Health Plan</u>		
Rate stabilization July – December 2016	\$7.0	
2017 Rate Stabilization	7.6	
Rate Stabilization 2018 and beyond	\$3.8	\$18.4
<u>Delta Dental</u>		
Rate Stabilization July – December 2016	\$0.6	
2017 Rate Stabilization	2.4	
Rate Stabilization 2018 and beyond	\$4.8	\$7.8
Healthcare Sustainability Fund		\$2.2
Performance Guarantees – Adoption and Surrogacy Benefit		
2017	\$0.3	
2018 – 2020	\$0.9	\$1.2
Total Obligations and Reserves		\$54.0

¹ Contingency reserves are to 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.

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, 2016, the Stabilization Reserves totaled \$18.5 million. The Board authorized use of \$10.0 million during Rates and Benefit process for 2017 which leaves a balance of \$8.5 million for rate stabilization in future years. Aon will reevaluate the reserves at the beginning of the 2017 Rates and Benefit process during which the 2018 rates are determined. The disposition of the reserve is as follows:

	Total Reserve	Amounts used for 2017 rates	Balance to be used for future years
City Health Plan reserves as of 12/31/2015	\$11.4	\$7.6*	\$3.8
Delta Dental reserves as of 12/31/2015	\$7.2	\$2.4	\$4.8
	<u>\$18.6</u>	<u>\$10.0</u>	<u>\$8.6</u>

**Includes \$3.8 Million of City Health Plan reserves approved by the Board in June 2016 to lower active and early retiree premiums*

Next Steps

KPMG issued the Trust’s Finance Statements as of June 30, 2016 with Independent Auditors’ Report on October 14, 2016. Hard copies are available at the HSS office (1145 Market, 3rd floor). The statements are also posted on myhss.org. The Comprehensive Annual Financial Report, issued on November 18, 2016, contains a high level summary of the Trust Fund.