

# 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 Reserves <sup>1</sup>		
City Health Plan	\$5.6	
Blue Shield	13.3	
Delta Dental	<u>\$3.1</u>	\$22.0
Stabilization reserves <sup>2</sup>		
<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

<sup>1</sup> Contingency reserves absorb the risk of claims in excess of expected claims targets.

<sup>2</sup> 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	\$ 1,156,813	\$ 1,178,746

### 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](http://myhss.org). The Comprehensive Annual Financial Report, issued in December 2017, contains a high-level summary of the Trust Fund.