CALIFORNIA HEALTH BENEFIT EXCHANGE
(COVERED CALIFORNIA)

Financial Statements and Reports Required by OMB Circular A-133,
Audits of States, Local Governments, and Non-Profit Organizations

Year ended June 30, 2015

(With Independent Auditors' Report Thereon)

CALIFORNIA HEALTH BENEFIT EXCHANGE
(COVERED CALIFORNIA)

Table of Contents

KPMG LLP
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Independent Auditors' Report

Board of Directors
California Health Benefit Exchange

Report on the Financial Statements

We have audited the accompanying financial statements of the California Health Benefit Exchange (Covered California) as of and for the year ended June 30, 2015 and the related notes to the financial statements, which collectively comprise Covered California's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Covered California as of June 30, 2015, and the changes in financial position and its cash flows thereof for the year then ended in accordance with U.S. generally accepted accounting principles.

KPMG

Emphasis of Matter

As discussed in note 1 to the financial statements, in 2015, Covered California adopted Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions* and Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. The July 1, 2014 beginning net position has been restated for the retrospective application of this new accounting guidance. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 4-12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted the required supplementary information for GASB Statement No. 68 *Accounting and Financial Reporting for Pensions* that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Supplementary and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Covered California's basic financial statements. The accompanying schedule of expenditures of federal awards, as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 20, 2017 on our consideration of Covered California'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* in considering Covered California's internal control over financial reporting and compliance.

KPMG LLP

Sacramento, California
March 20, 2017

The following discussion and analysis of the California Health Benefit Exchange's (Covered California) financial performance provides an overview of financial activities for the fiscal year ended June 30, 2015. Please read it in conjunction with Covered California's financial statements that follow this section.

Financial Statements

These required statements offer short-term and long-term financial information about Covered California. The statement of net position provides information about the nature and amounts of investments in resources (assets) and obligations (liabilities) at the close of the fiscal year. All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses, and changes in net position. This statement measures the success of Covered California's operations over the past year. The final required financial statement is the statement of cash flows. The primary purpose of this statement is to provide information about Covered California's cash receipts and cash payments during the reporting period. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities, and provides answers to such questions as where did cash come from and what was cash used for. The financial statements are prepared on the accrual basis in accordance with U.S. generally accepted accounting principles.

Accounting Changes

During fiscal year 2014-15 Covered California implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. This Statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expenses, and requires recognition of a liability equal to the net pension liability, which is measured as the total pension liability, less the amount of the pension's fiduciary net position. The implementation of GASB 68 resulted in Covered California recognizing a net pension liability of $53.5 million as of June 30, 2015. During fiscal year 2014-15 Covered California recognized pension expense of $4.0 million, deferred outflows of $11.1 million, and deferred inflows of $10.6 million. More information on Covered California's pension liability can be found in note 5.

Notes to Financial Statements

The notes provide additional information that is essential to the full understanding of the data provided in the financial statements. The notes to financial statements can be found on pages 16 through 27 of this report.

(Continued)

Condensed Summary of Net Position

A summary of Covered California's net position is presented below:

		June 30	
		2015	**2014**
Current and other assets	$	297,114,950	179,424,269
Capital assets		245,650,865	247,178,201
Total assets		542,765,815	426,602,470
Deferred outflows of resources		11,090,990	—
Total assets and deferred outflows of resources		553,856,805	426,602,470
Current liabilities		91,123,868	115,475,780
Noncurrent liabilities		8,544,873	3,266,847
Net pension liability		53,473,665	—
Total liabilities		153,142,406	118,742,627
Deferred inflows of resources		10,560,585	—
Total liabilities and deferred outflows of resources		163,702,991	118,742,627
Investment in capital assets		245,650,865	247,178,201
Unrestricted		144,502,949	60,681,642
Total net position	$	390,153,814	307,859,843

Condensed Summary of Changes in Net Position

A summary of Covered California's change in net position is presented below:

		June 30	
		2015	**2014**
Operating revenues	$	207,446,678	67,168,160
Operating expenses		399,815,350	353,438,337
Operating loss		(192,368,672)	(286,270,177)
Nonoperating revenue		306,986,449	324,154,982
Income before capital contributions		114,617,777	37,884,805
Capital contributions		27,669,396	150,389,957
Changes in net position		142,287,173	188,274,762
Total net position – beginning of year		307,859,843	119,585,081
Cumulative effect of accounting change		(59,993,202)	—
Total net position – end of year	$	390,153,814	307,859,843

The requirements of GASB 68 were effective for financial statements for fiscal years beginning after June 15, 2014. At the time provisions of GASB 68 were adopted, Covered California was not able to determine the amounts of all deferred inflows of resources and deferred outflows of resources related to pensions, so it was not practical to restate prior period financial statements.

Fiscal Year 2014-15

Financial Highlights

Covered California continued to rely on federal grant funding and enrollment fees for its operations. Covered California was awarded grants totaling $1.1 billion to establish the organization and operate through December 2014. However, Covered California received federal approval to use unspent grant funds for establishment expenditures through September 30, 2016. Under the statute that established Covered California, it cannot rely on State of California General Funds to support operations. And starting January 1, 2015, upon the expiration of authority to spend federal grant funds, it must be fully self-sufficient based on revenue raised in its operations. In accordance with state law, Covered California assesses enrollment fees on health insurance companies for policies sold to individuals and small businesses. However, as stated above, Covered California will have the ability to spend federal grant funds through September 30, 2016.

The fiscal year 2014-15 Covered California budget and expenditures were aligned with the organization's goal to continue the establishment process for the marketplace. In particular, the budget supported Covered California's goal of enrolling new Californians in coverage, providing a better consumer experience to applicants and enrollees, and retaining current enrollees. Central to these goals was to build enrollment as the organization went through the first renewal period and second open enrollment.

(Continued)

Funding for the fiscal year ended June 30, 2015 included federal grant funds and monthly fees assessed on qualified health plans. The budget was constructed in anticipation of Covered California transitioning from being exclusively funded by federal grants to being funded with assessment revenue. The approval of the extension of the federal grant gave Covered California more time to establish the organization as it worked toward its goal of identifying the most efficient and cost-effective structure possible.

The first renewal period and the new enrollment numbers for the second open-enrollment period were encouraging. In May 2014 Covered California released an enrollment forecast for the 2015 open-enrollment period and beyond. The forecast identified a range of potential enrollments based on the best estimates at the time. The overall enrollment number of approximately 1.4 million at the end of open enrollment was above the "low estimate" (1.3 million), but not as high as the "medium estimate" used for budgeting (1.7 million). One of the main reasons for the difference was that during the special-enrollment period, while the actual retention rate was better than projected, the transition of consumers out of Medi-Cal and into Covered California was more modest than anticipated. As a result, by December 2014, the base of consumers with an option to renew was lower than the medium forecast. Covered California has been able to use that experience to further sharpen its forecasts.

The expenditures for FY 2014-15 were lower than the adopted budget of $411.7 million. This was primarily the result of lower-than-budgeted expenditures in Outreach and Sales, Marketing; CalHEERS; unspent reserve/initiative funding; and salary savings. Similar to fiscal year 2013-14, during fiscal year 2014-15 the timing of significant expenditures occurred later than originally anticipated, which resulted in a delay of some expenditures to FY 2015-16.

Expenditure Summary by Major Areas

Service Center – expenditures were lower than budgeted as additional costs associated with third-party Service Center support for peak enrollment periods were offset by lower-than-expected operating and contractual expenditures. Service Center representatives handled much higher volumes during the open-enrollment period and at improved service levels.

CalHEERS – Covered California's projected expenditures were lower than budgeted, after cost sharing. The revised cost-allocation plan for CalHEERS expenses was approved and effective October 1, 2014.

Outreach and Sales, Marketing – expenditures for these programs in FY 2014-15 were lower than budgeted, largely because expenditure payments to Certified Enrollment Entities and Certified Insurance Agents on behalf of the Department of Health Care Services (DHCS) were lower than budgeted.

Plan Management and Evaluation – Fiscal year 2014-15 expenditures were lower than budgeted, primarily because of lower-than-expected expenditures on the data aggregation and analytics effort due to timing and lower expenditures on contractors and other operations costs.

Administration – expenditures were lower than the FY 2014-15 budget because costs associated with the building and maintenance were offset by lower overall operating expenditures.

Enterprise Shared Costs – expenditures were lower than originally budgeted because of lower-than-estimated mandatory Statewide Cost Allocation Plan and Statewide distributed administrative costs, as well as unexpended reserve funding.

(Continued)

Covered California's total net position increased by $82.3 million in FY 2014-15. The increase in FY 2014-15 over the prior fiscal year was due to an increase in operating revenues from enrollment fees from health insurance carriers.

Covered California's total net investment in capital assets was $245.7 million and $247.2 million at June 30, 2015 and 2014, respectively. The decrease in FY 2014-15 of 0.6% over the FY2013-14 was due to the revised cost allocation methodology for the share of the cost consistent with longstanding federal policy and practice and as set forth in Office of Management and Budget (OMB) Circular A-87, in those cases where Covered California shares functionalities with Medicaid and the Children's Health Insurance Program (CHIP). Those programs are required to pay their share to develop and implement the California Healthcare Eligibility, Enrollment and Retention System (CalHEERS). Previously the cost allocation was 82% Covered California and 18% DHCS. The new cost allocation was changed to 17.9% Covered California and 82.1% DHCS effective October 1, 2014. Covered California's total accumulated depreciation was $35.4 million and $25.4 million at June 30, 2015 and 2014, respectively. Additional costs will be capitalized and depreciated as Covered California moves towards final system completion.

Covered California's assets exceeded liabilities by $390.2 million and $307.9 million at the close of the fiscal years ended June 30, 2015 and 2014, respectively. In FY 2014-15, total current assets included cash and cash equivalents of $239.7 million, enrollment fees receivables of $41.8 million due from health insurance carriers and small businesses, and receivables from other state agencies of $14.3 million for reimbursements due from the Department of Health Care Services. Capital assets included the capitalized cost required for the continued implementation of CalHEERS as well as office furniture and equipment and leasehold improvements. Current liabilities included accounts payable for unpaid goods and services of $59.3 million and federal grant funds drawn prior to receiving federal guidance regarding establishment and implementation activities of $22.2 million. Noncurrent liabilities included net pension liability of $53.5 million. In FY 2013-14, current and other assets included grants receivable of $65.6 million due from the Federal government, enrollment fees receivables of $65.4 million from health insurance carriers and small businesses, and receivables from other state agencies of $27.0 million for reimbursements due from the Department of Health Care Services. Capital assets included the capitalized cost required for the development and implementation of CalHEERS as well as office furniture and equipment and leasehold improvements. Current liabilities included accounts payable for unpaid goods and services of $110.4 million.

Economic Outlook

Covered California spent its remaining federal establishment funds by the end of FY 2015-16 and began FY 2016-17, its first fiscal year relying on plan assessment revenues, with a prudent operating reserve. Consistent with its guiding financial principles, the reserve amount is based on maintaining a level that is sufficient to assure an adequate balance to address uncertainties and to allow for timing lags needed to adjust revenue and expenditures. The current Covered California enrollment forecast extends through 2020, and is based on two years of special enrollment activity, and three rounds of open enrollment, including two annual renewals. Continued enrollment growth is expected based on the projected growth of the number of Californians eligible for financial assistance through Covered California driven by underlying demographic trends and additionally, by the impact of the recently enacted increase to California's minimum wage that will increase in stages to $15 per hour in 2020. Thus, the forecast projects modest enrollment and revenue growth from 2016 through 2018 followed by more robust growth through 2020.

Various indicators point to the likelihood that Covered California's initial phase of rapid expansion will give way to a more stable phase, which leads to a more modest outlook than the previous forecast. Open enrollment for the 2016 benefit year resulted in enrollment within the range of previous forecasts. Based on the latest enrollment results reported by all Affordable Care Act marketplaces, the Kaiser Family Foundation estimates that among the best-performing states, which includes California, 90% of people eligible for subsidies have selected plans, which leaves little room for potential growth going forward.

Covered California is an important participant in a large and dynamic health insurance marketplace whose customer base is constantly changing in size, economic situation, as well as in health insurance needs. In addition to the 1.4 million Californians who have health policies purchased through Covered California, approximately 18 million receive health coverage through employers, 700,000 purchase individual coverage outside of Covered California, and more than 12 million are covered by Medi-Cal. Approximately 3 million remain uninsured, of which less than 1.4 million are eligible for subsidies. Of the latter, from 500,000 to 800,000 may be covered by COBRA, covered indirectly by an employer, or may be in transition between employer-based coverage, Covered California and Medi-Cal.

According to the analysis performed by PriceWaterhouseCoopers (PwC), the most significant impact to the exchange eligible population will be the recently enacted minimum wage increase. Boosting income for those near the subsidy eligibility range will lead to shifts from Medi-Cal to Covered California. Among the various external drivers considered by the PwC analysis, the impact of a rising minimum wage is expected to be the most significant driver of additional enrollment through 2020.

The forecast also incorporates a change in the assessment from a flat per-member, per-month (PMPM) rate to a percentage of gross premiums paid beginning in 2017. A 4% of premium assessment fee will be assessed on the 1.4 million currently enrolled in Covered California plans. In addition to Covered California enrollees, there are also approximately 700,000 people in the individual market who benefit from the rates negotiated by Covered California, even though they are not directly enrolled through Covered California. The total number of members in the individual market is approximately 2.1 million. The Affordable Care Act requires the rates for these products (both on and off exchange) to be the same. Since the health plans offered by Covered California represent approximately 66% of the total enrollment in individual coverage, the Affordable Care Act assessment essentially requires the health plans to spread the assessment fee across the entire individual market. To the extent that carriers have members that do not purchase through Covered California, but who pay the same rate, results in the actual assessment being spread across the entire individual market for those health plans offered by Covered California. Covered California estimates that the actual average effective assessment rate for 2017 will be approximately 2.6% across the entire market.

In addition to the enrollment and eligibility insights, PwC also concluded that Covered California incurs significant costs related to acquisition activities, similar to other organizations with high membership churn rates. These acquisition expenditures in turn help reduce acquisition costs incurred by participating insurance carriers.

(Continued)

Forecasting Potential Enrollment

The 2015 enrollment forecast benefited from the experience and lessons learned in 2014. In contrast, the 2016 forecast reflects the experience of two years of enrollment history as well as insights from comprehensive market analysis completed by PwC in concert with demographic modeling experts at the University of California. The forecast combines the two perspectives into a balanced outlook.

The 2015 benefit year and 2016 open enrollment experience indicate that Covered California will likely see more stable enrollment trends going forward. Open enrollment activity for the 2016 benefit year was more modest than for 2015 primarily due to a more compressed schedule and a smaller uninsured population likely to enroll in Covered California. Special enrollment activities provided additional opportunities for individuals to enroll in 2015 and was stronger than 2014. This was due to a longer special enrollment period and the temporary additional qualifying event given to individuals who were unaware of the tax implications of remaining uninsured.

These developments are reflected in the 2016 forecast by shorter open enrollment periods, as currently anticipated, lower special enrollment gains and slightly higher disenrollment. Thus, the 2016 enrollment forecast is anchored in the 2014 and 2015 experiences with some modest projections for growth, largely due to income impacts caused by minimum wage increases. It is critical to note that while "net" enrollment reflects only moderate growth, this is based on Covered California continuing to do extensive marketing, sales and retention activities required to newly enroll from 700,000 to 900,000 each year as many enrollees leave Covered California's coverage to get employer-sponsored coverage, Medi-Cal, Medicare or other coverage. At the end of the third open enrollment, Covered California reached enrollment of 1.4 million individuals.

Individual Market Forecast

This projection begins after the third open-enrollment period and takes into account the following:

- The pace that new enrollees acquired coverage through Covered California during 2015 special enrollment.
- The rate at which enrolled individuals leave Covered California through termination or by failing to renew coverage.
- The likelihood that an individual who selects a plan will pay their premium.
- The seasonal distribution of enrollment activity throughout the benefit year.
- The size of the California population eligible for subsidies.
- The impact of rising minimum wage on the subsidy eligible population.
- Potential medical cost trends reflected in premiums.

For the next several years, open enrollment activities will continue to outpace special enrollment activities and be the primary driver of enrollment growth. Enrollment growth is projected through 2020.

(Continued)

Revenue and Change in Health Insurance Premiums

The revenue forecast reflects a shift to a percent of premium assessment in 2017, with a rate of 4%. All models reflect the same trend assumptions for gross health insurance premiums, which was projected to increase by 8% in 2017 and 5% each year through 2020. The projected increase in 2017 is driven by the assumed impact of the sunset of the Transitional Reinsurance Program and the Risk Corridors Program – temporary federally sponsored high claimant risk mitigation programs. The termination of these programs will put a one-time upward pressure on health insurance gross premiums. After 2017, premiums are forecast to increase at 5% each year, driven by annual cost increases (weighted average basis) in Hospital Services (1%), Professional Medi-Cal Services (2%), and Pharmaceuticals (2%).

Annual individual plan assessments are projected to decrease as a percentage of premiums, as total premiums increase, in upcoming years. On a budgetary basis, Covered California projects $245.4 million in individual market revenues will be generated in FY 2015-16; $249 million in 2016-17; $300.9 million in 2017-18; $319 million in 2018-19; and $325.5 million in 2019-20.

Covered California for Small Business Forecast

The enrollment outlook of Covered California for Small Business (CCSB) (previously identified as the Small Business Health Options Program, or SHOP), builds on the operational improvements and the continuing migration of the small business market to products that meet requirements of the Affordable Care Act. Operational improvements include enrollment system functionality now performing at market standard and improved agent support. Both of which have received positive market response. Additionally, as of January, 2016, the definition of the small business market expanded from one to 50 eligible employees to a new ceiling of 100. This change requires groups in the 51-100 segment to ensure coverage offered effective January 2016 or after is ACA compliant. As the beginning of 2016 approached, the 51-100 market saw early renewal activity in which groups who were due to renew coverage in January 2016 choose instead to renew in late 2015 to maintain their current plans. This was similar to the migration pattern seen in 2013 as the January, 2014 compliance for the under 50 segment approached.

While start up challenges in 2014 hampered initial sales and retention, service improvements are beginning to be reflected in expanded enrollment in CCSB. Broker engagement, which is the channel responsible for the vast majority of small business enrollment across the market, is growing.

Overall, CCSB enrollment is expected to rise through 2020 due to the positive impact of the following factors:

- The market is recognizing the value of exchange products. This includes parity in market pricing, employers offering employees an array of choice, employer ability to budget premium contributions, and single billing administration. This is leading to exchanges being more attractive to the market than seen in years past.
- Expected improvements to the CCSB offering portfolio both in terms of carriers and plans offered.
- CCSB offers tax credits for up to 50% of eligible employer's contribution to health coverage for two consecutive taxable years.
- The continuing migration of employers in the 51-100 market to Affordable Care Act compliant plans.

- Covered California having addressed a majority of the initial launch challenges and developing additional operational capabilities to further improve both the employer and agent experience.

Starting in 2017, the CCSB assessment is calculated as a percent of gross medical premium. The rate for 2017 is 5.2% of premiums which is equivalent to the $18.60 per member per month fee currently assessed. This assessment does not include the additional amount which is collected and paid to agents for their commission-based enrollment activities.

Covered California Revenue Summary

Revenues which include both the individual and Covered California for Small Business markets, are calculated on a cash basis that more accurately reflect the actual timing of the collection of revenue.

The forecast for the individual market includes plan assessments budgeted at a level of 4% of premium for 2017 and 2018, and budgeted at 3.75% in 2019 and 3.5% in 2020. Covered California for Small Business plan assessments are budgeted at a level of 5.2% of premium for the duration of the forecast. The forecast does include revenue from family dental coverage, which is assessed at the same rates as the medical coverage offered on the individual and CCSB markets. To the extent enrollment varies from the medium forecast, Covered California would be able to adjust its revenue by increasing or decreasing the plan assessment, or by adjusting its budgeted expenditures. Adjustments in the plan assessment are estimated to take approximately nine to 18 months to have an impact on plan assessment revenue.

Based upon the multi-year forecast, Covered California does not expect the fiscal year end reserve level to be less than seven months at any time throughout the outlook. The reserve level is based on the revenue forecast rather than the total net position as the net position includes noncurrent liabilities such as pension liabilities for State employees, which are an obligation of the State rather than Covered California. It is important to note that each year a new multi-year forecast will be completed based on the most current information, so the estimates presented here could change. The below table summarizes the revenue projections derived from the Individual Market and Covered California for Small Business forecasts described above.

Covered California revenue outlook summary
Medium forecast alternatives

Market		Revenue ($millions) 2015–16	2016–17	2017–18	2018–19	2019–20
Fiscal year						
Individual market – medical	$	245.4	249.0	300.9	319.0	325.5
Individual market – dental		—	0.9	1.1	1.1	1.1
CCSB		5.5	9.8	15.6	22.8	31.3
Total revenue	$	250.9	259.7	317.6	342.9	357.9

CALIFORNIA HEALTH BENEFIT EXCHANGE
(COVERED CALIFORNIA)

Statement of Net Position

June 30, 2015

Assets and Deferred Outflows		
Current assets:		
Cash and cash equivalents	$	239,675,495
Receivables:		
Enrollment fees (net of allowance for cancelled enrollments)		41,836,437
Receivables from state agencies		14,302,044
Other receivables		1,269,253
Total receivables		57,407,734
Other current assets		31,721
Total current assets		297,114,950
Noncurrent assets:		
Capital assets, net		245,650,865
Total assets		542,765,815
Deferred outflows of resources		11,090,990
Total assets and deferred outflows of resources	$	553,856,805
Liabilities and Deferred Inflows		
Current liabilities:		
Accounts payable	$	59,337,860
Grants received in advance		22,186,084
Accrued liabilities		1,690,861
Deferred revenue		3,998,380
Compensated absences		3,910,683
Total current liabilities		91,123,868
Noncurrent liabilities:		
Compensated absences		1,805,854
Other liabilities		6,739,019
Net pension liability		53,473,665
Total noncurrent liabilities		62,018,538
Total liabilities		153,142,406
Deferred inflows of resources		10,560,585
Total liabilities and deferred inflows of resources	$	163,702,991
Net Position		
Net investment in capital assets	$	245,650,865
Unrestricted		144,502,949
Total net position	$	390,153,814

See accompanying notes to financial statements.

CALIFORNIA HEALTH BENEFIT EXCHANGE
(COVERED CALIFORNIA)

Statement of Revenues, Expenses, and Changes in Net Position

Year ended June 30, 2015

Operating revenues:		
Enrollment fees-individual	$	204,314,367
Enrollment fees-CCSB		3,132,311
Total operating revenues		207,446,678
Operating expenses:		
Salaries, wages, benefits		80,232,822
Operating expenses and equipment		7,701,831
Professional services		250,258,509
Enrollment assistance fees		18,897,592
Facilities operations		6,976,657
Communications		379,769
Depreciation expense		35,368,170
Total operating expenses		399,815,350
Operating loss		(192,368,672)
Nonoperating revenues:		
Federal grants		287,868,268
State – reimbursements		18,902,293
Interest income		215,888
Total nonoperating revenues		306,986,449
Income before capital contributions		114,617,777
Capital contributions:		
Federal		27,669,396
Total capital contributions		27,669,396
Change in net position		142,287,173
Total net position – beginning of year, as previously stated		307,859,843
Cumulative effect of accounting change		(59,993,202)
Total net position – beginning balance, as restated		247,866,641
Total net position – end of year	$	390,153,814

See accompanying notes to financial statements.

CALIFORNIA HEALTH BENEFIT EXCHANGE
(COVERED CALIFORNIA)

Statement of Cash Flows

Year ended June 30, 2015

Cash flows from operating activities:		
Receipts from enrollment fees	$	234,548,511
Payments to employees and for employee benefits		(81,658,956)
Payments to suppliers		(290,066,946)
Net cash used in operating activities		(137,177,391)
Cash flows from noncapital financing activities:		
Operating grants		336,520,123
State – reimbursements		21,268,328
Net cash provided by noncapital financing activities		357,788,451
Cash flows from capital and related financing activities:		
Capital grants		54,534,343
Acquisition of capital assets		(56,907,145)
Net cash provided by capital and related financing activities		(2,372,802)
Cash flows from investing activities:		
Interest income		88,079
Net increase in cash and cash equivalents		218,326,337
Cash and cash equivalents – beginning of year		21,349,158
Cash and cash equivalents – end of year		239,675,495
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss		(192,368,672)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation		35,368,170
Changes in assets and liabilities:		
Decrease in accounts receivable		27,101,833
Increase in other assets		(28,067)
Increase in pension obligations		(530,405)
Decrease in accounts payable and grants received in advance		(5,824,520)
Decrease in accrued liabilities		(7,213,268)
Increase in compensated absences		1,067,619
Increase in other liabilities		5,249,919
Net cash used in operating activities	$	(137,177,391)
Supplemental disclosure of noncash activities:		
Capital asset purchases included in accounts payable	$	15,801,740

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

(a) Organization

The California Health Benefit Exchange (Covered California) was created on September 30, 2010 as an independent public entity with the passage of Assembly Bill 1602, enacting the federal Patient Protection and Affordable Care Act (Affordable Care Act). Under the Affordable Care Act signed into law in March 2010, states were required to decide whether to create a state-based health insurance exchange or participate in the federal multistate health insurance exchange. The State of California (the State) elected to establish a state-based health insurance exchange. In 2010, State law was enacted to implement the provisions of the Affordable Care Act to reduce the number of uninsured Californians by creating an organized, transparent marketplace for Californians to purchase affordable, quality healthcare coverage offered in four categories, or tiers, each with a metal rating of Bronze, Silver, Gold, and Platinum.

Covered California is not a component unit of the State. Covered California is a related organization.

(b) Basis of Presentation

The financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles. Under this method, revenues are recorded when earned and expenses are recorded when the related liability is incurred.

(c) Revenue Recognition

Revenues are classified as operating or nonoperating in the accompanying Statement of Revenues, Expenses and Changes in Net Position. Operating revenues began in fiscal year 2013-14, and result from monthly enrollment fees assessed on health insurance companies for policies sold through the marketplace for the individual and Covered California for Small Business (CCSB) programs.

In the individual market, Covered California charges the health insurance carriers a per-member-per-month fee, which is set annually for effectuated members. For fiscal year 2014-15, the per-member-per-month fee was $13.95 per medical enrollee and $0.83 per dental enrollee.

In the CCSB market, Covered California charges the health insurance carriers a per-member-per-month fee, which is set annually for effectuated members. For fiscal year 2014-15, the per-member-per-month fee was $18.60 per medical enrollee and $0.83 per dental enrollee.

Covered California recognizes individual and CCSB enrollment fee revenues when effectuated enrollment occurs and the fees are earned from the health insurance carriers. All revenues received that are not part of the ongoing operations, such as capital and operating assistance grants and interest income, are classified as nonoperating revenues.

(d) Cash and Cash Equivalents

Cash and cash equivalents represent cash deposited in the Surplus Money Investment Fund (SMIF) and cash on hand with the State Treasurer.

(Continued)

(e) *Receivables*

Receivables represent amounts owed by the California Department of Health Care Services (DHCS) for its share of the costs related to California Healthcare Eligibility, Enrollment, and Retention System (CalHEERs) of $14.3 million as of June 30, 2015. Receivables also include amounts due from health insurance carriers and small businesses for enrollment fees in the amount of $41.8 million, which is net of cancelled enrollments of approximately $2.8 million, amounts due from employees of $194,756, and amounts due from the Surplus Money Investment Fund (SMIF) of $132,724.

(f) *Capital Assets*

Capital assets are defined as assets which have a unit cost of $5,000 or greater and a useful life of more than one year. Capital assets are stated at cost. Depreciation on equipment is calculated using the straight-line method over the estimated useful life ranging from 2 to 20 years. Depreciation on internally generated software and purchased software is calculated using the straight-line method over the estimated useful life of 10 and 5 years, respectively. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in the period of disposal. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the lease term or the useful life.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 51, *Accounting and Reporting for Intangible Assets*, Covered California has recorded internally generated computer software that is in the development stage; however, the system went live on October 1, 2013. Intangible assets are considered internally generated if they are created or produced by the department or an entity contracted by the department, or if they are acquired from a third party but require more than minimal incremental effort on the part of the department to begin to achieve their expected level of service capacity. The preliminary project stage was completed in June 2012. Application development costs incurred from July 2014 through June 30, 2015 were $30 million. Depreciation of the assets began on October 1, 2013, and totaled $35.4 million for fiscal year 2014-15.

(g) *Accounts Payable and Grants Received in Advance*

Accounts payable represents amounts owed by Covered California to third parties. Grants received in advance is reported net of grants receivable and includes federal grant funds drawn prior to receiving Frequently Asked Questions guidance issued by the Centers for Medicare & Medicaid Services (CMS) in June 2015 and other advance payments received.

(h) *Compensated Absences Payable*

Vacation balances are accrued as a liability as earned.

(i) *Enrollment Assistance Fees*

Covered California entered into a contract with DHCS whereby DHCS compensates certified enrollment entities and agents for successful consumer enrollment and effectuation in Medi-Cal. The compensation is either $58 or $29 depending on enrollment factors. Covered California pays these fees on behalf of DHCS. The funds to pay these fees are collected in advance from DHCS.

(j) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(k) Pensions

During the year ended June 30, 2015, Covered California adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. GASB Statement No. 68 revises existing standards for measuring and reporting pension liabilities. This statement requires recognition of a liability equal to the net pension liability, which is measured as the total pension liability, less the amount of the pension plan's fiduciary net position. The total pension liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits. This Statement requires that most changes in the net pension liability be included in pension expense in the period of the change. Due to the adoption of GASB 68, Covered California reduced its beginning net position, as shown on the statement of revenues, expenses, and changes in net position, by $60.0 million.

For purpose of measuring the net pension liability, deferred outflows and inflows of resources related to pensions, and pension expense, information contained within Covered California has been determined on the same basis as they are reported by the California Public Employees' Retirement System (CalPERS) Financial Office.

(l) Deferred Outflows of Resources and Deferred Inflows of Resources

Changes in net pension liability not included in pension expense are reported as deferred outflows of resources or deferred inflows of resources. Employer contributions subsequent to the measurement date of the net pension liability are reported as deferred outflows of resources. The unamortized net difference between projected and actual earnings on investments are recorded as deferred inflows of resources.

(2) Cash and Cash Equivalents

Cash and cash equivalents are held as cash on hand in pools and managed by the State Treasurer. They are not evidenced by securities. Interest income earned on outstanding cash balances is allocated among pool participants based on average daily cash balances.

State treasury	$	27,069,495
Surplus money investment fund (SMIF)		212,606,000
Total	$	239,675,495

As of June 30, 2015, the carrying value of deposits in the SMIF represents the fair value. The SMIF consists of the available cash of all special funds of the State which do not have investment authority of their own. Cash balances in excess of needs in any of these participating funds are invested by the State Treasurer. The Pooled Money Investment Board (PMIB) provides regulatory oversight over the State Treasurer's pooled investment program and is responsible for determining whether any cash balances of the participating funds are in excess of current needs and available for investment, or whether it is necessary to liquidate previous investments to meet current requirements. The PMIB is composed of the State Treasurer, as chairman; the State Controller; and the Director of Finance for the State.

All of the resources of the SMIF are invested through the Pooled Money Investment Account (PMIA). By law, PMIA monies can be invested only in the following categories: U.S. Government securities; securities of federally sponsored agencies; domestic corporate bonds; interest-bearing time deposits in California banks, savings and loan associations, and credit unions; prime-rated commercial paper; repurchase and reverse repurchase agreements; security loans; banker's acceptances; negotiable certificates of deposits; and loans to various bond funds.

At June 30, 2015, the allocation of the deposits held by Covered California in the SMIF was estimated as follows:

	Covered California's share of SMIF
U.S. Treasury securities	$ 100,909,867
Federal agency debt	27,392,542
Supranational debentures	1,375,024
Bank notes	2,138,079
Certificates of deposit	44,746,993
Commercial paper	18,085,191
Time deposits	16,608,418
AB 55 and General Fund Loans	1,349,886
Total	$ 212,606,000

The value of the deposits in the State Treasurer's pooled investment program, including the SMIF, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2015, this difference was immaterial to the valuation of the deposits held by Covered California in the SMIF.

Covered California's share in the interest earnings of the PMIA is based on its ratio of dollar-day contributions to the total dollar-day investments of the PMIA. The overall return on investment for the PMIA was 0.27% for the year ended June 30, 2015.

(3) Capital Assets

Changes in capital assets for the year ended June 30, 2015 are as follows:

	Balance July 1, 2014	Increases	Decreases	Balance June 30, 2015
Depreciable assets-development costs:				
Internally developed software	$ 207,379,877	28,147,421	—	235,527,298
Hardware	21,772,260	990,677	—	22,762,937
Licenses and purchased software	39,567,465	1,262,163	—	40,829,628
Total depreciable assets development costs	268,719,602	30,400,261	—	299,119,863
Depreciable capital assets:				
Office furniture and equipment	3,465,602	1,054,428	—	4,520,030
Leasehold improvements	381,871	2,386,145	—	2,768,016
Total depreciable capital assets	3,847,473	3,440,573	—	7,288,046
Less accumulated depreciation:				
Asset development costs	(24,754,450)	(34,293,964)	—	(59,048,414)
Office furniture and equipment	(585,462)	(819,555)	—	(1,405,017)
Leasehold improvements	(48,962)	(254,651)	—	(303,613)
Total accumulated depreciation	(25,388,874)	(35,368,170)	—	(60,757,044)
Total capital assets, net	$ 247,178,201	(1,527,336)	—	245,650,865

(4) Leases

Covered California leases office space for its headquarters and Service Centers under operating leases. The lease terms vary, with the oldest expiring April 30, 2022.

The future minimum lease payments under operating leases as of June 30, 2015 are as follows:

For the year ending June 30:	
2016	$ 6,192,361
2017	6,192,361
2018	6,192,361
2019	6,192,361
2020	5,219,107
Thereafter	6,511,317

Rental expense for operating leases totaled $5.5 million for the year ended June 30, 2015.

(5) Retirement Planning and Other Postemployment Benefits

Retirement Plan

As discussed in note (1), Covered California adopted GASB 68 during the 2014-15 fiscal year. GASB 68 requires that the reported results pertain to liability and asset information within certain defined timeframes. For this report, the following timeframes are used:

Valuation date (VD)	June 30, 2013
Measurement date (MD)	June 30, 2014
Measurement period (MP)	July 1, 2013 to June 30, 2014

At the time provisions of GASB 68 were adopted, Covered California was not able to determine the amounts of all deferred outflows and inflows of resources related to pensions, so it was not practical to restate the prior period financial statements.

Plan Description, Benefits Provided, and Employees Covered

Covered California contributes to the Public Employees' Retirement Fund administered by the California Public Employees' Retirement System (CalPERS), an agent multiple-employer public employee defined benefit pension plan. Covered California has employees who are enrolled in the State Miscellaneous Plan (First Tier and Second Tier). CalPERS provides retirement benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public entities within the State and uses the accrual basis of accounting. Benefit provisions and all other requirements are established by state statute.

CalPERS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. CalPERS' annual financial report may be obtained by writing to the California Public Employees' Retirement System, Fiscal Services Division, P.O. Box 942703, Sacramento, California 94229 or by visiting the CalPERS Web site at www.CalPERS.ca.gov.

Generally, full-time employees are eligible to participate as members of CalPERS and are eligible to retire at age 50 with at least five years of service or age 55 with at least ten years of service, depending on the plan selected by the employee. However, the Public Employees' Pension Reform Act, or PERA, was passed in 2012 and went into effect on January 1, 2013. This new law changed the terms of the pension plan for state workers first hired after January 1, 2013. Annual retirement benefits are determined based on age at retirement, the length of membership service, and the amount of earnings based on the highest or last 12 or 36 consecutive months' average compensation. Healthcare and dental benefits may be provided to members depending on the date hired and the years of credited service of a member. If members are not fully vested, the healthcare and dental contributions will be prorated based on the years of service.

Contributions

Section 20814 (c) of the California Public Employees' Retirement Law (PERL) requires that the employer contribution rates for all public employees are determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. The total plan contributions are determined through the CalPERS' annual actuarial valuation process. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The employer is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. For the Miscellaneous Plan measurement period ended June 30, 2014, the average active employee contribution rate is 6.525% of annual pay, and the employer's contribution rate is 21.137% of annual payroll. These rates reflect PERL Section 20683.2, which mandates that certain employees contribute more as of July 1, 2013. Furthermore, any reduction in employer contributions due to the increase in the employee contributions must be paid by the employer towards the unfunded liability. It is the responsibility of the employer to make necessary accounting adjustments to reflect the impact due to any employer-paid member contributions or situations where members are paying a portion of the employer contribution.

Discount Rate

In preparation for implementing GASB 68, CalPERS prepared the GASB 68 Accounting Valuation Reports (AVRs) for the State of California for the eight plans (including the State Miscellaneous Plan) in which the State participates. CalPERS utilized a discount rate of 7.65%, which includes the plans' administrative expenses.

Pension Liabilities, Pension Expense, and Deferred Outflows and Deferred Inflows of Resources Related to Pensions

The State Controller's Office (SCO) used a calculated percentage based on Covered California's share of the pensionable compensation to the State's total pensionable compensation amounts for the State Miscellaneous Plan, to provide Covered California's net pension liability and related GASB 68 accounting elements. Covered California's calculated percentage was 0.224583% for the State Miscellaneous Plan. Using this percentage, Covered California's net pension liability for the State Miscellaneous Plan was $64.8 million at the beginning of the measurement period (MP) and $53.5 million at the end of the MP.

As of the start of the measurement period, July 1, 2013, the net pension liability was $64,836,493.

For the measurement period ending June 30, 2014 (the measurement date), Covered California Fund incurred a pension expense of $4,041,048.

As of June 30, 2014, Covered California Fund had deferred outflows of resources of $11,090,990 and deferred inflows of resources of $10,560,585.

(Continued)

Exclusive of deferred outflows related to payments after the measurement date, the net amount of deferred outflows (inflows) of resources related to pensions that will be recognized in pension expense during the next five years and thereafter is as follows:

		Miscellaneous plan
Measurement period ended June 30:		
2015	$	(2,640,146)
2016		(2,640,146)
2017		(2,640,146)
2018		(2,640,146)
Total	$	(10,560,584)

Actuarial Methods and Assumptions Used to Determine Total Pension Liability

The total pension liability was based on an actuarial valuation as of June 30, 2013, rolled forward to June 30, 2014, based on the following actuarial methods and assumptions:

Actuarial Cost Method:	Entry Age Normal in accordance with the requirements of GASB Statement No. 68
Amortization Method/ Period:	Actuarial Policy ACT-96-05E specifies that all changes in liability due to plan amendments, changes in actuarial assumptions, or changes in actuarial methodology are amortized separately over a 20-year period. In addition, all gains or losses are tracked and the net unamortized gain or loss is amortized as a rolling 30-year amortization with the exception of gains and losses in fiscal years 2008-09, 2009-10 and 2010-11 in which years' gains or losses will be isolated and amortized over fixed and declining 30-year periods (as opposed to the current rolling 30-year amortization). Also, if a plan's accrued liability exceeds the actuarial value of assets, the annual contribution with respect to the total unfunded liability may not be less than the amount produced by a 30-year amortization of the unfunded liability. Finally, all plans are subject to a minimum employer contribution rate equal to the employer normal cost plus a 30-year amortization or surplus, if any.
Asset Valuation Method:	Fair Value
Inflation:	2.75%
Salary Increases:	Varies by entry age and service
Payroll Growth:	3.00%

Investment Rate of Return:	7.65%
Retirement Age:	The probabilities of retirement are based on the 2010 CalPERS Experience Study for the period from 1997 to 2007
Mortality Rate Table:	The probabilities of mortality are based on the 2010 CalPERS Experience Study for the period from 1997 to 2007. Pre-retirement and post-retirement mortality rates include 5 years of projected mortality improvement using Scale AA published by the Society of Actuaries.
Post Retirement Benefit Increase:	Contract COLA up to 2.75% until purchasing power protection allowance floor on purchasing power applies.

The Mortality Rate Table used was developed based on CalPERS specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB. For more details on the Mortality Rate Table, please refer to the 2014 experience study report.

All other actuarial assumptions used in the June 30, 2013, valuation were based on the results of an actuarial experience study for the period from 1997 to 2011, including updates to salary increase, mortality and retirement rates. The Experience Study report can be obtained at a CalPERS website under Forms and Publications.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, CalPERS' staff took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Such cash flows were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years. Using historical returns of all the funds' asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

(Continued)

The table below reflects long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. An expected inflation rate of 2.5% was used for real return years 1-10. For real return years 11+, an inflation rate of 3% was used. These geometric rates of return are net of administrative expenses.

Asset class	New strategic allocation	Real return Years 1-10	Real return Years 11+
Global equity	47.00 %	5.25 %	5.71 %
Global fixed income	19.00	0.99	2.43
Inflation sensitive	6.00	0.45	3.36
Private equity	12.00	6.83	6.95
Real Estate	11.00	4.50	5.13
Infrastructure and forestland	3.00	4.50	5.09
Liquidity	2.00	(0.55)	(1.05)
Total	100.00 %		

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of Covered California as of June 30, 2014, calculated using the discount rate of 7.65%, as well as what the pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.65%) or 1 percentage point higher (8.65%) than the current rate:

Miscellaneous plan	$ 78,664,948	53,473,664	31,857,619

Pension Plan Fiduciary Net Position

Each plan's fiduciary net position disclosed in the accounting valuation report provided by CalPERS may differ from the plan's assets reported in the funding actuarial valuation report due to several reasons; the accounting valuation report must keep items such as deficiency reserves, fiduciary self-insurance, and OPEB expenses included as assets. These amounts are excluded for rate setting purposes in the funding actuarial valuation report.

Other Postemployment Benefits

Postretirement healthcare benefits are also provided to Covered California employees through the programs sponsored by the State as administered by CalPERS and the California Department of Human Resources (CalHR). As the postretirement healthcare plan is sponsored by the State, it is considered a single-employer plan. The total other postemployment benefits (OPEB) actuarial accrued liability is reported at the State level.

(Continued)

Healthcare and dental benefits may be provided to members depending on the date hired and the member's years of credited service. Postretirement health benefits include medical, prescription drug, and dental benefits and are currently funded on a pay-as-you-go basis. Employer contributions for health premiums during fiscal year 2014-15 maintained the 100/90% contribution formula established by Government Code. Under this formula, the State uses 100% of the weighted average premiums of the four largest health benefit plans in order to calculate the maximum amount the State will contribute toward the retiree's health benefits. The State also contributes 90% of this average for the health benefits of each of the retiree's dependents. The retiree is responsible for paying all health benefit plan costs that exceed the average of the four largest benefit plans. The monthly contribution maximums are $655 for a single enrollee, $1,246 for an enrollee and one dependent, and $1,605 for an enrollee and two or more dependents. Dental premiums vary by plan and number of dependents. The contribution formulas are subject to approval and amendment by the legislature of the State. If members are not fully vested, the healthcare and dental contributions will be prorated based on the years of service.

Covered California paid approximately $1.5 million for postretirement health and dental benefits for retired members for the year ended June 30, 2015. Covered California has adopted GASB Statement No. 45. Covered California's annual OPEB cost (AOC) is calculated based on the annual required contribution (ARC). The AOC recorded by Covered California is calculated by the State and represents an allocation of the total ARC of the State, adjusted for interest and other adjustments. The allocation is based on Covered California's retiree health benefit costs in relation to the total State retiree health benefit costs. The ARC represents normal cost plus an amortization of the difference between the actuarial accrued liability and any asset available to pay benefits. For the year ended June 30, 2015, Covered California's AOC was $8.0 million and Covered California's increase in net OPEB obligation (NOO) was $5.0 million. The following table shows the components of Covered California for the year ended June 30, 2015 and the previous two fiscal years.

Net OPEB obligation (NOO), July 1, 2013	$	125,482
Allocated annual OPEB cost (AOC)		1,632,434
Fund allocated contributions		(578,440)
Net OPEB obligation (NOO), July 1, 2014		1,179,476
Allocated annual OPEB cost (AOC)		7,991,912
Fund allocated contributions		(3,017,172)
Net OPEB obligation (NOO), June 30, 2015	$	6,154,216

The actuarial valuation report for OPEB can be obtained by writing to the Office of the State Controller, P.O. Box 942850, Sacramento, California 94250 or by visiting the State Controller's website at www.SCO.ca.gov.

(6) Commitments and Contingencies

As of June 30, 2015, Covered California has outstanding commitments of $59.6 million related primarily to information technology projects.

Covered California receives federal awards. Receipts from federal grants are subject to audit to determine if the funds were expended in accordance with appropriate statutes, grant terms, and regulations. Any disallowed expenditures resulting from such audits become a liability of Covered California. Management does not believe such adjustments, if any, would materially affect the financial condition or operations of Covered California.

(7) Risk Management

Covered California is self-insured through the State Department of General Services (DGS) Office of Risk and Insurance Management (ORIM) for risks of employee errors and omissions, business interruption, and comprehensive insurance. The ORIM provides risk management and insurance services to state and other public entities on an ongoing or project-specific basis. There have been no significant reductions in insurance coverage from the prior year. In addition, no insurance settlement in the last three years has exceeded insurance coverage. All claims are on a “pay-as-you-go” basis.

Liabilities for workers’ compensation costs are accrued based on estimates derived from the State Compensation Insurance Fund. This estimate is based on actuarial reviews of employee workers’ compensation program and includes indemnity payments compensation benefits and leave benefits. The liability for workers’ compensation is not material to the financial statements as a whole.

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Independent Auditors' 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*

Board of Directors
California Health Benefit Exchange

We have audited, in accordance with the 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, the financial statements of the California Health Benefit Exchange (Covered California), which comprise the statement of net position as of June 30, 2015, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 20, 2017. Our report includes an emphasis of matter paragraph related to Covered California's adoption of Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions and Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date*. The July 1, 2014 beginning net position has been restated for the retrospective application of this new accounting guidance.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Covered California's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Covered California's internal control. Accordingly, we do not express an opinion on the effectiveness of Covered California's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We consider the deficiency described as 2015-001 in the accompanying schedule of findings and questioned costs to be a significant deficiency.

KPMG

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Covered California's financial statements are free from 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*.

Covered California's Response to the Finding

Covered California's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Covered California's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Covered California's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Covered California's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Sacramento, California
March 20, 2017

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Independent Auditors' Report on Compliance for Each Major Federal Program; Report on Internal Control over Compliance Required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*

Board of Directors
California Health Benefit Exchange

Report on Compliance for Each Major Federal Program

We have audited the California Health Benefit Exchange's (Covered California) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on Covered California's major federal program for the year ended June 30, 2015. Covered California's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for Covered California's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Covered California's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of Covered California's compliance.

Opinion on Each Federal Program

In our opinion, Covered California complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2015.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2015-002 and 2015-003. Our opinion on the major federal program is not modified with respect to this matter.

Covered California's responses to the noncompliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Covered California's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

Report on Internal Control over Compliance

Management of Covered California is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Covered California's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Covered California's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first preceding paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as items 2015-002 and 2015-003, that we consider to be significant deficiencies.

Covered California's responses to the internal control over compliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Covered California's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

KPMG LLP

Sacramento, California
March 20, 2017

CALIFORNIA HEALTH BENEFIT EXCHANGE
(COVERED CALIFORNIA)

Schedule of Expenditures of Federal Awards

Year ended June 30, 2015

Federal grantor	Program title	CFDA No.	Federal expenditures
U.S. Department of Health and Human Services	State Planning and Establishment Grants for the Affordable Care Act (ACA)'s Exchanges	93.525	$ 315,537,664

CALIFORNIA HEALTH BENEFIT EXCHANGE
(COVERED CALIFORNIA)

Notes to Schedule of Expenditures of Federal Awards

June 30, 2015

(1) Basis of Accounting

The accompany Schedule of Expenditures of Federal Awards is presented on the accrual basis.

(2) Relationship to Federal Financial Reports

The regulations and guidelines governing the preparation of federal financial reports vary by federal agency and among programs. Accordingly, the amounts reported in the federal financial reports do not necessarily agree with the amounts reported in the accompanying Schedule which is prepared on the basis explained in note 1.

CALIFORNIA HEALTH BENEFIT EXCHANGE
(COVERED CALIFORNIA)

Schedule of Findings and Questioned Costs

June 30, 2015

(1) Summary of Auditors' Results

A. The type of report issued on the financial statements: **Unmodified Opinion**

B. Material weaknesses: **None**

Significant deficiencies in internal control disclosed by the audit of the financial statements: **Yes**

C. Noncompliance that is material to the financial statements: **None**

D. Significant deficiencies in internal control over major program: **Yes**

Material weaknesses: **None**

E. The type of report issued on compliance for the major program: **Unmodified opinion**

F. Any audit findings that are required to be reported under Section 0.510(a) of OMB Circular A-133: **Yes**

G. Major program:

93.525	State Planning and Establishment Grants for the Affordable Care Act (ACA)'s Exchanges

H. Dollar threshold used to distinguish between Type A and Type B programs: **$3,000,000**

I. Auditee qualified as a low-risk auditee under Section 0.530 of OMB Circular A-133: **No**

(2) Financial Statement Findings Section

Financial Reference Number: 2015-001

During our audit for fiscal year 2013-14, we reported that Covered California lacked adequate controls to ensure its financial statements were accurate and complete. In fiscal year 2014-15, we found Covered California continued to lack adequate controls to ensure its financial statements were fairly presented in accordance with generally accepted accounting principles (GAAP). During our audit, we found that Covered California does not have adequate controls in place to review the top-side journal entries made to report amounts in accordance with generally accepted accounting principles. We identified the following errors in the financial statements which were corrected by Covered California.

Revenue:

1. At June 30, 2015, Covered California did not properly update its financial statement accounts to reduce per-member, per-month (PMPM) revenue for actual members effectuated, resulting in an overstatement of accounts receivable and revenues of approximately $2.2 million.

2. Covered California erroneously reduced Federal Grant Receivable and Revenue by $6.9 million in compiling top-side journal entries for GAAP purposes, and therefore, the ending grant receivable balance did not agree to actual amounts owed by the Federal Government.

3. Covered California erroneously double-booked a receivable from the Federal Government to reflect additional expenditures incurred at year-end, resulting in an overstatement of Federal Grant Revenue and Receivable of approximately $1.0 million.

4. Covered California erroneously reversed prior year top-side accrual entries in the current year for Accounts Receivable and Accounts Payable, resulting in an understatement of $1.4 million in each of these balance sheets accounts, and the related revenue and expense.

Capital Assets:

1. Covered California had a formula error in the spreadsheet used to calculate annual depreciation on intangible assets, resulting in an understatement of accumulated depreciation and depreciation expense of approximately $3.0M.

2. Covered California had approximately $2.3M of capital asset improvements that were expensed and not capitalized during the year, resulting in an understatement of capital assets and an overstatement of operating expenses.

Other State Agencies:

1. Covered California did not properly update its financial statements to reflect amounts billed for revenue from the Department of Healthcare Services (DHCS) and understated its receivables and revenues by approximately $2.1 million.

2. Invoices from other State Agencies relating to prior periods in the amount of $1.2 million were not received by Covered California until late in fiscal year 2014-15. Covered California recognized this $1.2 million in the current year that should have been reported in the prior period.

Recommendations

Covered California should develop policies to ensure the financial statements are accurately presented in accordance with generally accepted accounting principles. Specifically, Covered California should:

- Perform periodic reconciliations to the general ledger for amounts billed for PMPM revenue.
- Perform a detailed review of all top-side entries and related support to ensure the accuracy of these entries.
- Review spreadsheets used in making calculations to ensure all data points are properly captured.
- Evaluate operating expenses to ensure they do not meet the criteria for capitalization.
- Evaluate invoices with DHCS to ensure the revenue and receivable balances are accurately reported.
- Continue working with other State Agencies to ensure invoices are received timely in order to reflect the activity within the proper period.

Covered California's View and Corrective Action Plan

Covered California immediately implemented corrective actions for identified top-side journal entries. Covered California is performing reconciliations to the general ledger for its revenue accounts, continues to review GAAP entries for accuracy including calculations. Covered California has also engaged in dialog with other state agencies to obtain timely invoices.

Contact

Jim Lombard, Chief Financial Officer

Implementation Date

Continuous implementation.

(Continued)

(3) Federal Awards Findings Section

Reference Number:	2015-002
Awarding Agency:	U.S. Department of Health and Human Services
Program Name:	State Planning and Establishment Grants for the Affordable Care Act (ACA)'s Exchanges
CFDA No.:	93.525
Federal Award Year:	2014-15
Federal Award Number:	HBEIE130148-01-09
Category of Finding:	Activities Allowed or Unallowed/Allowable Costs/Cost Principles
Type of Finding:	Significant Deficiency and Instance of Noncompliance

Criteria

2 CFR Part 225, Cost Principles for State, Local, and Indian Tribal Governments (OMB Circular A-87), Appendix B to Part 225 – Selected Items of Cost

16. Fines and penalties. Fines, penalties, damages, and other settlements resulting from violations (or alleged violations) of, or failure of the governmental unit to comply with, Federal, State, local, or Indian tribal laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the Federal award or written instructions by the awarding agency authorizing in advance such payments.

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133 – AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS (OMB Circular A-133), Subpart C – Auditees, Section .300 – Auditee Responsibilities. (b) The auditee shall maintain internal control over federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements related to each of its federal programs

Condition

In testing expenses for allowable costs/cost principles, we noted that grant funds were used to pay a legal settlement to a former employee. The settlement costs were paid in lieu of incurring litigation proceeding costs, and Covered California used grant funds to pay this expenditure. Such settlement costs are not allowable under OMB Circular A-87, and Covered California lacked adequate expenditure review controls to identify this before they claimed them as Federal expenditures. As a result, Covered California has incurred unallowable costs under the terms of the grant agreement.

Questioned Costs

$55,000

(Continued)

Recommendation

Covered California should reimburse the disallowed costs to the Federal Government. In addition, Covered California should use its sustainability funds to cover future such expenses.

Covered California's View and Corrective Action Plan

We concur with this finding. The Financial Management Division (FMD) reviewed expenditures through FY15-16 to ensure no costs resulting from violations of, alleged violations of, or failure to comply with, Federal, state, tribal, local or foreign laws and regulations were charged to the Federal grant. For the specific questioned cost, the expenditure was corrected and charged against sustainability funds.

Covered California concurs that a transaction for a single payment in the amount of $55,000 was posted to the incorrect fund. Covered California disagrees that an error for a single payment is indicative of a lack of adequate expenditure review controls.

Contact

Jim Lombard, Chief Financial Officer

Implementation Date

Implementation began on July 26, 2015 and is complete.

Auditors' Conclusion

The identification of questioned costs when performing our audit procedures indicates that expenditure review controls need to be improved.

Reference Number:	2015-003
Awarding Agency:	U.S. Department of Health and Human Services
Program Name:	State Planning and Establishment Grants for the Affordable Care Act (ACA)'s Exchanges
CFDA No.:	93.525
Federal Award Year:	2014-15
Federal Award Number:	HBEIE130148-01-09
Category of Finding:	Activities Allowed or Unallowed/Allowable Costs/Cost Principles
Type of Finding:	Significant Deficiency and Instance of Noncompliance

(Continued)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133 – AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS (OMB Circular A-133), Subpart C – Auditees, Section 300 – Auditee Responsibilities. (b) The auditee shall maintain internal control over federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements related to each of its federal programs.

Section 1311. AFFORDABLE CHOICES OF HEALTH BENEFIT PLANS

(5) Funding Limitations

(A) NO FEDERAL FUNDS FOR CONTINUED OPERATIONS. − In establishing an Exchange under this section, the State shall ensure that such Exchange is self-sustaining beginning on January 1, 2015, including allowing the Exchange to charge assessments or user fees to participating health insurance issuers, or to otherwise generate funding, to support its operations.

OMB Circular A-87 Revised Cost Principles for State, Local, and Indian Tribal Governments, Section C. Basic Guidelines:

1. Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

   a. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.

   b. Be allocable to Federal awards under the provisions of this Circular.

Condition

During fiscal year 2014-15, Covered California claimed certain expenditures that were not allowable under the provisions of Section 1311 of the Affordable Care Act and OMB Circular A-87. Beginning January 1, 2015, Covered California was required to comply with Section 1311 (5)(A) of the Affordable Care Act which provides for the use of sustainability funds to cover ongoing operating expenditures. Covered California did not have adequate expenditure review controls in place to identify these expenditures prior to claiming them with the Federal government. Based on discussions with Covered California management and audit testing performed, Covered California identified approximately $9.7 million of grant expenditures incurred subsequent to January 1, 2015 and claimed thereafter that were identified as unallowable costs as they related to ongoing operations. Covered California management identified the unallowable costs based on the Frequently Asked Questions guidance issued by the Centers for Medicare & Medicaid Services (CMS) in June 2015, and has indicated that the Federal Government was reimbursed for such costs through a reduction of draws submitted subsequent to its 2014-15 fiscal year end. In addition, Covered California identified approximately $2.4 million of other expenditures that should have been funded with sustainability funds instead of grant funds.

(Continued)

Questioned Costs

$12,164,509

Recommendation

Covered California should strengthen its existing monitoring controls surrounding changes in allowability requirements to ensure that all expenditures claimed under the grant meet the grant requirements.

Covered California's View and Corrective Action Plan

Covered California disagrees with this finding. The Condition statement above does not provide sufficient timing detail regarding the advice received on allowable costs from CMS on June 8, 2015 that was retroactive to January 1, 2015; therefore, the suggested recommendation of strengthening monitoring controls would not have avoided the adjustments noted above. At the time that the expenditures occurred, the costs were allowable and Covered California was in compliance with Section 1311 (5) (A). However, on June 8, 2015, three weeks before the end of the state fiscal year, and six months after the beginning of the self-sustainability period cited in Section 1311 (5) (A), CMS released, "FAQs on the Clarification of the Use of 1311 Funds for Establishment Activities", which described allowable uses of 1311 funds after January 1, 2015 for establishment activities that were specifically described in the grantee's approved work plan. Based on this new information Covered California reviewed expenditures and made timely adjustments. All expenditure adjustments were completed before the end of the 2014-15 state fiscal year and no corrective action is necessary.

Further, the CMS confirmed that the June 8, 2015 FAQs were issued as additional guidance to assist States on continuing ACA activities. Due to the timing of the FAQs, CMS expected that State based marketplaces would require some accounting adjustments consistent with the additional guidance. Covered California's expenditure adjustments and subsequent offsets to grant draws was a reasonable and appropriate effort to mitigate the impact of the June 8, 2015 guidance.

Covered California was proactive and had appropriate expenditure reviews in place prior to claiming Federal expenditures. Covered California could not have predicted that CMS would provide additional guidance six months after the sustainability period began. At the time that the expenditures occurred, the costs were allowable and Covered California was in compliance with Section 1311 (5) (A).

Contact

Jim Lombard, Chief Financial Officer

Implementation Date

Review of the FAQs began in June 2015 and expenditure corrections were completed. No further action is necessary.

Auditors' Conclusion

The additional guidance provided by CMS in its publication of the Frequently Asked Questions further clarified the types of expenditures that were no longer allowable under the grant as of January 1, 2015. As the Affordable Care Act included a requirement to use sustainability funds to cover ongoing operating expenditures, we concluded that the questioned costs above were not allowable during the reporting period from January 1, 2015 to June 30, 2015.