2003 Joint Committee on Audit

Health Insurance Risk-Sharing Program

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DEC 18 2003

December 18, 2003

Helene Nelson, Secretary
Department of Health and Family Services
1 West Wilson Street
Room 650
Madison, WI
Inter-Departmental

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Dear Helene:

I am writing in relation to the recent Legislative Audit Bureau's report of the Health Insurance Risk-Sharing Plan (HIRSP), and specifically on oversight on the program's prescription drug benefit management.

Although facing difficult increases in costs, I believe that the audit prepared by the Bureau portrayed an accurate picture of the HIRSP program. The program, faced with increasing caseloads, is working hard to provide the benefits offered to HIRSP enrollees.

In order to continue this evaluation of the HIRSP program, I would encourage you and the Department to accept the Audit Bureau's recommendation and actively pursue a "SAS 70" audit or another alternative to fully evaluate the pharmacy benefit management component of HIRSP.

Information is a critical component of ensuring that every health care dollar is invested wisely and with the best interest of the care recipient in mind. With prescription drug costs being a major portion of both MA and HIRSP costs, we need to guarantee that money is being spent on the people who need it, prices are being negotiated that are in the best interest of the program, and administrative overhead is kept to a minimum.

I am very pleased that in other areas of the program, the Department took a proactive lead and streamlined fee structures in order to implement a more efficient administrative structure. It is my hope that we can continue this effort in the pharmacy benefit portion of HIRSP to maximize every program dollar.

Thank you in advance for your time on this issue. Should you have any questions or comments, please feel free to contact me.

Sincerely,

Kitty

Kitty Rhoades
Member
Joint Committee on Finance

CC: Representative Sue Jeskewitz, Co-Chair, Joint Legislative Audit Committee
Senator Carol Roessler, Co-Chair, Joint Legislative Audit Committee

Wisconsin Medical Society

Your Doctor. Your Health.

For Immediate release
April 14, 2004

For Information Contact:
Alice O'Connor (608) 225-9391
Mark Grapentine (608) 575-2514

HIRSP Audit Shows Need to Expand Funding Base

Important Program's Costs Soar As Caseload Increase Continues

Madison – Today's release of the Legislative Audit Bureau's (LAB) audit of the Health Insurance Risk-Sharing Plan (HIRSP) program reveals a growing need for expanding the program's funding base as costs continue to mount, according to the Wisconsin Medical Society.

"It's time for the Governor and Legislature to re-examine who contributes to this valuable program," says Michael Reineck, MD, President of the Wisconsin Medical Society. "When you look at where costs are increasing, it makes sense to find a way to include additional funding sources in the equation."

The audit (number 04-3) shows that the program cost $85.8 million to insure 17,017 people in 2002-03 – a 27.8 percent cost increase over 2001-02, and an increase of more than 170 percent in the last five years. The LAB notes that while caseload growth may be leveling, the increase in the number of participants plus increased costs of medical care accounts for most of the increase overall. Claims for prescription drugs in HIRSP now represent 37.8 percent, or $32.4 million, of the net claims paid in 2002-03.

HIRSP was established in 1980 to provide insurance for individuals with severe conditions unable to find health coverage in the private market. Costs for HIRSP are divided 60-20-20 among individual premiums, insurers and health care providers respectively. Adding to the funding pressure is the state's decision to stop partially funding the program. While the state contributed $21 million in general funds during the 2001-03 biennium, the administration and legislature eliminated any state contribution for 2003-05.

Noting the audit's finding that providers contributed $26,160,080 to HIRSP in FY 2002-03 through discounted services, Reineck says the legislature should reexamine a proposal that would add drug manufacturers and labelers to the group contributing 40 percent of HIRSP costs. That proposal, Senate Bill 466, was introduced very late in the just-expired regular legislative session and received only a public hearing in the Assembly.

"When the audit points out that the second-largest cost to the HIRSP program is prescription drugs, that may be a logical place for the administration and legislature to look," Reineck said.

According to the audit, HIRSP received just $677,118 in FY 2002-03 in drug rebates.

The Wisconsin Medical Society is the largest association of medical doctors in the state with more than 10,000 members dedicated to the best interests of their patients. With that in mind, *wisconsinmedicalsociety.org* offers patients a unique source for reliable, physician-reviewed medical information. The Wisconsin Medical Society, a trusted source for health policy leadership since 1841.

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Health Insurance Risk-Sharing Plan

Legislative Audit Bureau
May 2004

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HIRSP Background

- Established to provide major medical insurance for those who cannot obtain private coverage for health reasons
- Also provides coverage to those who have lost employer-sponsored health insurance
- 18,273 policyholders enrolled as of 5/31/04
- DHFS oversees the Plan

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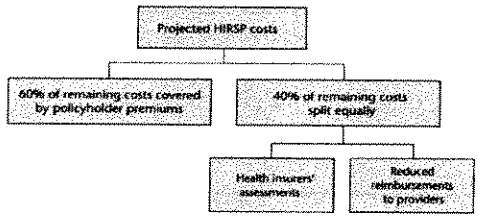
Program Funding



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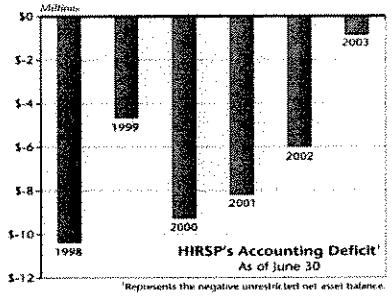
Financial Position



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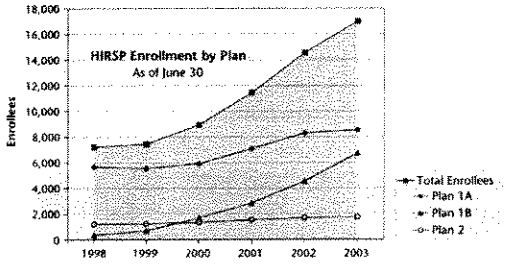
Increasing Enrollment



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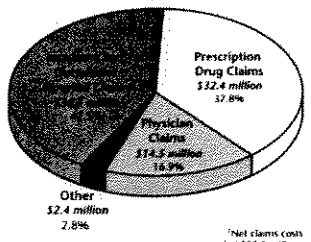
Types of Claims Paid During FY 2002-03



[1]Net claims costs totaled $85.8 million.

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Audits of Controls

- Independent internal control audits of HIRSP's pharmacy benefit management company would provide additional assurance that necessary safeguards and controls are in place and working
- DHFS will require independent reviews in its future contract for HIRSP's plan administrator

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Technical Statutory Issue

- Funding formula overcredits policyholders for deductible and drug subsidies because of a technical statutory provision
- A portion of related costs are not being allocated to any funding party
- DHFS and the Board plan to pursue statutory changes to address the issue in the 2005-07 legislative session

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Jim Doyle
Governor

Helene Nelson
Secretary

State of Wisconsin
Department of Health and Family Services

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TESTIMONY FOR JOINT LEGISLATIVE AUDIT COMMITTEE HEARING REGARDING THE HEALTH INSURANCE RISK SHARING PLAN

Mark B. Moody, Administrator
Division of Health Care Financing
June 24, 2004
Capitol, 411 South

Introduction

My name is Mark Moody and I am the Administrator of the Division of Health Care Financing in the Department of Health and Family Services. I am also the Chairperson of the HIRSP Board of Governors. I am here today to offer comments on the Legislative Audit Bureau's audit of the Health Insurance Risk Sharing Plan, or HIRSP, for state fiscal year 2003.

Today, HIRSP is providing insurance coverage to more Wisconsin residents than ever before. I believe the LAB audit clearly shows that the program is in the best financial shape it has ever been in.

Background

Catastrophic medical expenses are a leading cause of personal bankruptcy in the United States. According to a national study by Norton's Bankruptcy Advisor, 40% of bankruptcy filings in 1999 – approximately 500,000 – were due to huge medical expenses.

Nationally, about 1 to 2% of the population is both uninsured and uninsurable.

There are 33 high-risk pools nationwide. As of December 2002, Wisconsin's was fourth in total enrollment behind Minnesota, Texas and California (in that order).

A 1998 study by the Urban Institute concluded that high-risk pools contribute to keeping health insurance markets competitive, insurance rates more affordable, and help reduce Medicaid enrollment and increase private coverage. In other words, the benefits of risk pools accrue to more than HIRSP policyholders. They accrue to all the citizens, insurance carriers and taxpayers of Wisconsin.

By one measure of market concentration, the percent of the market of the largest insurer, Wisconsin has the least concentrated individual insurance market in the United States. By another measure of market concentration, the percent of the market of the top three insurers, Wisconsin has the second least concentrated individual insurance market in the United States.

This means Wisconsin has the most competitive individual market in the US; good news for all of us.

A number of states have attempted to solve the problem of the uninsured by mandating guaranteed issue in the individual market, but have had to retreat after their individual markets collapsed.

It is evident that HIRSP is meeting the health insurance needs of an increasing number of Wisconsin residents and is now one of the largest issuers of individual coverage in the state.

Current Situation

As I said earlier, I believe the LAB audit clearly shows HIRSP is in the best financial shape it has ever been in and the plan is serving more Wisconsin residents than ever before.

As of May 31, 2004, there were 18,273 people enrolled in HIRSP. The Department and the HIRSP Board have been successful at controlling HIRSP costs:

The budget approved by the Board at its April 21, 2004, Board meeting for SFY 2005 is approximately $7 million *less* than the budget approved by the Board for SFY 2004.

Insurance industry assessments are approximately $3 million less for the coming year ($32 million for SFY 2005 vs. $35 million for SFY 2004).

Policyholder premiums remain at 140% of the standard rate, the *lowest level permitted by law*. On average, policyholder premiums will increase 12.8%.

Payment rates to most providers will increase.

Administrative expenses, as a percent of total program costs, continue to decline. Total administrative costs, as a percent of total program costs, actually declined in SFY 2002-03 and account for only 4.9% of program costs (5.3% in SFY 2002). This is far less than any commercial insurance company serving the individual market!

HIRSP's accounting deficit decreased by $5.1 million from SFY 2001-02 to SFY 2002-03 and, as of June 30, 2003, to less than $1 million. Since June 30, 2000, the Department and the Governing Board have worked effectively to reduce the accounting deficit by more than $8 million.

Net assets increased by approximately $12.5 million in SFY 2002-03.

Average claims costs per policyholder increased by only 10.7% in SFY 2002-03. This increase is approximately 3% lower than medical cost increases experienced for health care for commercial plans or for state employees.

Any commercial plan would be very pleased with these results.

As part of ongoing efforts to improve the Plan's operations, the Department issued a Request for Proposal for a new Plan Administrator contract in January. Three vendors submitted proposals on April 23, 2004. The new contract will streamline operations by bringing currently separate administrative functions under one contract. In addition, disease management may be added to improve quality and reduce costs. We expect to have a new contract in place in July 2004 with implementation of a new Plan Administrator early in 2005.

Current Challenges for HIRSP

HIRSP was originally created by the Legislature as a pool for the state's medically uninsurable, and then later modified to serve as Wisconsin's response to federal HIPAA laws and to provide access to health insurance for Wisconsin residents who lose their health insurance through their employer.

The dramatic growth in enrollment is clearly a significant challenge for HIRSP. Since policyholder premiums only pay 60% of program expenses, assessments on the insurance industry have been increasing quite dramatically. HIRSP assessments are material relative to industry profit margins. We are, of course, very pleased to be reducing industry assessments this year.

Funding is the most pressing challenge facing risk pools nationally and in Wisconsin. No risk pools in the country operate on policyholder premiums alone; 100% run at a deficit.

Virtually all states rely on insurance industry assessments to fund risk pool deficits. Generally this leaves self-funded plans largely exempt from assessment.

Oregon was the first state to implement risk pool assessment based on covered lives as a way to get at the self-funded market. Since then, Colorado and New Hampshire have adopted assessments based on covered lives as a way to engage self-funded plans and employers in funding their high-risk pools.

A number of states use general fund appropriations to fund risk pool deficits. Unfortunately, this funding method is frequently associated with enrollment caps and waiting lists as state support often fails to keep pace with the rate of growth in pool deficits.

Minnesota historically used provider taxes (excluding hospitals, nursing homes, pharmacies and ambulatory surgery centers) to cover a portion of their risk pool deficit.

Conclusion

HIRSP is working. It deftly balances the sometimes opposing interests of consumers, providers and insurance carriers. HIRSP is not in need of major surgery or reform. Tipping the balance to favor me or another of its stakeholder groups would likely do more harm than good and potentially undermine the consensus that makes the program viable.

Wisconsin Association of Health Plans

June 24, 2004

To: The Honorable Carol Roessler, Co-Chair, Legislative Audit Committee
The Honorable Sue Jeskewitz, Co-Chair, Legislative Audit Committee
Honorable Committee Members

From: Kelly M. Rosati, JD,
Government Affairs Consultant

Re: Legislative Audit Bureau Report 04-3,
Health Insurance Risk Sharing Plan (HIRSP)

The Legislative Audit Bureau Report 04-3 provides excellent documentation of the dramatic cost increases experienced in the state's Health Insurance Risk Sharing Plan (HIRSP) program.

As you examine the reasons for those cost increases, the Wisconsin Association of Health Plans encourages you to remember that these cost increases create an even higher unfair and hidden tax on Wisconsin's small employers who purchase private group health insurance coverage.

HIRSP was established in 1980 as the insurer of last resort to provide a public safety net for Wisconsin's citizens unable to obtain private health insurance. It is funded 60% from policyholder premiums, 20% from insurer assessments and 20% from provider discounts.

As the audit points out, during the 2001-03 biennium, state general purpose revenue (GPR) for HIRSP totaled $21.0 million. However, under 2003 Wisconsin Act 33, the 2003-05 Biennial Budget Act, all GPR was eliminated, exacerbating the HIRSP funding crisis.

As noted in the audit report, both HIRSP enrollment and claims costs continue to increase.

Some key findings include the following:

- As of February 29, 2004, 17,669 policyholders were enrolled in HIRSP, which represents a 120% increase in the past four years.
- Claims costs increased 171% or $54.2 million over the last five years.
- Prescription drug claims represented 37.8% of the $85.8 million in net claims paid during FY 2002-03.

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- In FY 2001-02 and FY 2002-03, insurer assessments increased 162.7%.

The Association believes there must be wholesale, systemic change to HIRSP in order to preserve the important and original public policy purpose for which it was established: to act as an insurer of last resort providing a public safety net to those who, for health reasons, are unable to obtain insurance in the private market.

To best support this important program, there should be a fair funding formula. The Association believes the current HIRSP funding formula is inequitable in three fundamental ways:

1. It punishes small employers who purchase insurance while large, self-funded plans pay nothing;
2. It allows drug manufacturers whose drugs account for nearly 40% of claims cost to contribute nothing to the cost of the program; and,
3. It includes no GPR to support a publicly created, safety net program.

In order to address these inequities and propose a solution to the problem, the Association joined with a coalition of stakeholders in 2003-04 to advance a legislative proposal for change. This proposal, represented in AB 840 & SB 466, would have broadened the funding formula for HIRSP to include drug manufacturers and made other policy changes. The reform proposals received public hearings in the Assembly and Senate Health Committees but failed to advance from those committees.

So while the Association continues to believe a more equitable funding formula would make good public policy, the Legislature sent a clear message last session that the approach outlined in AB 840 and SB 466 was not the preferred route of legislators.

As a result, the Association created a Special HIRSP Reform Committee comprised of health plan CEOs to develop an alternative recommendation for bold change to HIRSP.

The focus of our efforts will be on the cost containment side of HIRSP rather than on broadening the funding base or securing GPR.

HIRSP's costs are increasing, in large part, because HIRSP in an antiquated program that has failed to adjust to an ever-changing health insurance marketplace. As noted in the audit, HIRSP was established in 1980. That makes the structure and benefit design of HIRSP nearly 25 years old.

It is past time HIRSP is modernized and greater flexibility is provided to the Board of Governors. The Association's Special HIRSP Reform Committee will continue its deliberations and then present a formal legislative recommendation to the Association's Board of Directors.

Once approved, we look forward to working with all HIRSP stakeholders and policymakers to advance a proposal that will secure long-overdue change to HIRSP. It is only through such bold reform that this important safety net program will be strengthened and secured for its current and future participants.

Thank you for the opportunity to testify.

Wisconsin Medical Society

Your Doctor. Your Health.

TO: Members, Joint Audit Committee

FROM: Alice O'Connor & Mark Grapentine

DATE: June 24, 2004

RE: HIRSP Audit Report 04-3

On behalf of more than 10,000 members statewide, thank you for this opportunity to provide feedback on Audit Report 04-3, regarding the state's Health Insurance Risk-Sharing Program. We believe that the Legislature, armed with this audit, is now poised to bring HIRSP funding strategy into the 21st century as you prepare to tackle the 2005-07 biennial budget.

We applaud the Legislative Audit Bureau's fine work found in Report 04-3; it shows dramatically the growing need for expanding the program's funding base as costs continue to mount. The Society hopes you will give this suggestion serious consideration as you prepare to tackle the 2005-07 biennial state budget.

The audit shows the need to revisit the existing HIRSP funding formula. Most eye-opening is the description of the staggering costs of prescription drugs: claims for prescription drugs in HIRSP now represent 37.8 percent, or $32.4 million, of the net claims paid in 2002-03, yet the formula does not reflect this dramatic change. Only three entities currently bear those costs under the current formula: participants (60 percent), providers (20 percent) and insurers (20 percent).

As our president, Michael Reineck, MD, stated in April when the audit first came out, "When the audit points out that the second-largest cost to the HIRSP program is prescription drugs, that may be a logical place for the administration and legislature to look." We agree, and support any efforts to include drug manufacturers and labelers in the group contributing 40 percent of HIRSP costs.

Perhaps the most powerful point is the simple comparison of two numbers: how much providers currently contribute to HIRSP vs. pharmaceutical companies efforts. According to the audit, **providers contributed $26,160,080** to HIRSP in FY 2002-03 through discounted services, while **drug rebates totaled $677,118** over the same period. Clearly, this is a disparity needing redress.

As always, please feel free to contact us with your questions or thoughts. Alice O'Connor can be reached at aliceo@wismed.org or by phone at 442.3767. Mark Grapentine can be contacted via markg@wismed.org or 442.3768.

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State of Wisconsin \ LEGISLATIVE AUDIT BUREAU

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APR 13 2004

DATE: April 13, 2004

TO: Karen Asbjornson and Pamela Matthews
Committee Clerks to the Joint Legislative Audit Committee

FROM: Diann Allsen
Financial Audit Director

SUBJECT: Report 04-3: An Audit of the Health Insurance Risk-Sharing Plan

At the request of the Department of Health and Family Services (DHFS), we have performed an audit of the financial statements of the Health Insurance Risk-Sharing Plan (HIRSP) for fiscal year (FY) 2002-03. HIRSP provides medical insurance for individuals unable to obtain private coverage. More than 17,000 policyholders are enrolled in the plan. We are able to provide an unqualified opinion on the HIRSP financial statements.

HIRSP's financial position again improved during FY 2002-03. Its accounting deficit decreased by $5.1 million to reach $0.9 million as of June 30, 2003. However, HIRSP experienced significant increases in enrollment and claims costs during FY 2002-03, although more recent statistics from FY 2003-04 suggest that enrollment may be beginning to slow. Insurers and health care providers, who share in funding HIRSP's costs along with policyholders, have been concerned with the effect of increasing costs on the size of contributions they are required to make to HIRSP. As a result, an area of continuing interest is the expansion of the funding base for HIRSP, especially related to prescription drug costs, which represented 37.8 percent of net claims costs. Currently, only a small amount of drug rebates are received from drug manufacturers and pharmacies are statutorily excluded from contributing toward HIRSP's costs.

DHFS has been responsive to our prior audit recommendation to require independent reviews of controls of the pharmacy benefit management company that processes HIRSP pharmacy claims. It has included a requirement for such audits in its Request for Vendor Proposals as part of a competitive procurement process currently underway to select the HIRSP plan administrator that will begin administering HIRSP in January 2005. We will continue to monitor enrollment and claims costs trends during our next financial audit of HIRSP.

We expect the report to be released on April 14, 2004 at 9:00 a.m. If you have any questions, please contact me.

DA/bm

Enclosures

04-3

An Audit:

Health Insurance Risk-Sharing Plan

Department of Health and Family Services

April 2004

Report Highlights

HIRSP's financial position improved during FY 2002-03.

Policyholder enrollment and claims costs continue to increase.

The 2003-05 Biennial Budget Act included changes to HIRSP.

A technical issue in HIRSP's statutory funding formula needs legislative attention.

The Health Insurance Risk-Sharing Plan (HIRSP) was established in 1980 to provide medical insurance for individuals who cannot obtain coverage in the private market because of the severity of their health conditions. In the late 1990s, it was also designated as Wisconsin's plan to meet federal Health Insurance Portability and Accountability Act (HIPAA) regulations and to provide health insurance to people who lose employer-sponsored group health insurance and meet other specified criteria.

HIRSP is primarily funded through policyholder premiums; financial assessments on health insurance companies that do business in Wisconsin; reduced reimbursements to health care providers; and, until recently, general purpose revenue (GPR). As of February 29, 2004, 17,669 policyholders were enrolled in HIRSP.

HIRSP offers eligible applicants three plans:

- The primary plan, plan 1A, is similar to coverage provided by many private major medical plans.
- The alternative plan, plan 1B, offers the same coverage as plan 1A but at lower premium rates because policyholders pay a higher deductible before HIRSP begins paying claims.
- An additional plan, plan 2, is available to Wisconsin residents under the age of 65 who participate in the federal Medicare program because of a disability.

At the request of the Department of Health and Family Services (DHFS), we completed our sixth financial audit of HIRSP. Our audit report contains our unqualified opinion on HIRSP's financial statements and related notes for the fiscal years ending June 30, 2003 and 2002.

Key Facts and Findings

HIRSP is funded through policyholder premiums, insurer assessments, and reduced reimbursements to health care providers.

We have issued an unqualified opinion on HIRSP's FY 2002-03 financial statements.

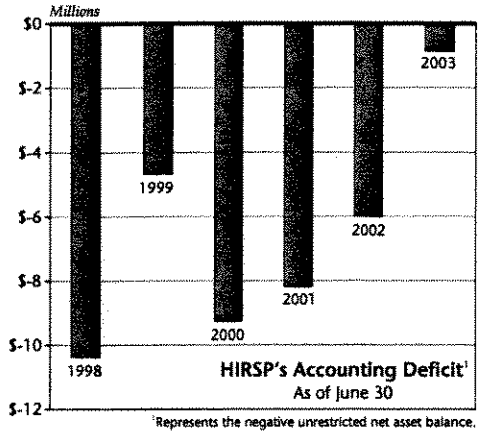
HIRSP's accounting deficit decreased by $5.1 million to reach $0.9 million as of June 30, 2003.

The excess policyholder premium account balance increased significantly during FY 2002-03, from $3.0 million to $10.4 million as of June 30, 2003.

Prescription drug claims represented 37.8 percent of the $85.8 million in net claims paid during FY 2002-03.

Financial Status of the Plan

Because of its cash-based funding approach, HIRSP had an accounting deficit of $8.2 million as of June 30, 2001. This deficit represented estimated additional cash that HIRSP would eventually need to pay covered medical expenses that had been incurred but not paid before this date.



DHFS and HIRSP's Board of Governors implemented an accrual-based funding approach beginning with fiscal year (FY) 2001-02. An accrual basis takes into account the full costs associated with events that occur during a plan year, including actuarial cost estimates for incurred claims that may not be filed until after the plan year.

The change to an accrual-based approach required funding to eliminate the accounting deficit that had accumulated under the cash-based approach, as well as funding for newly incurred costs accounted for on an accrual basis.

As a result of increasing enrollment and program costs, as well as the change in the funding approach, policyholder premiums and insurer assessments increased significantly in FY 2001-02 and FY 2002-03. Total premium revenue almost doubled, while insurer assessments increased 162.7 percent.

The increased revenues that resulted from increases in premiums and insurer assessments contributed to a $5.1 million reduction in HIRSP's accounting deficit, which was $0.9 million as of June 30, 2003.

Statutes require policyholders to fund 60 percent of HIRSP's costs and establish a floor for policyholder premiums of at least 150 percent of standard risk rates through July 29, 2002, and 140 percent of standard risk rates as of July 30, 2002. Statutes also require a separate accounting of premiums received in excess of the amount needed to cover policyholders' 60 percent share of HIRSP's costs.

Because the statutory floor for premium rates has typically been greater than the premiums needed to fund 60 percent of HIRSP's costs, and because actual claims costs were less than the costs assumed in HIRSP's FY 2002-03 budget, the excess policyholder premium account balance increased significantly during FY 2002-03, from $3.0 million to $10.4 million as of June 30, 2003.

The use of these funds is statutorily restricted for these purposes:

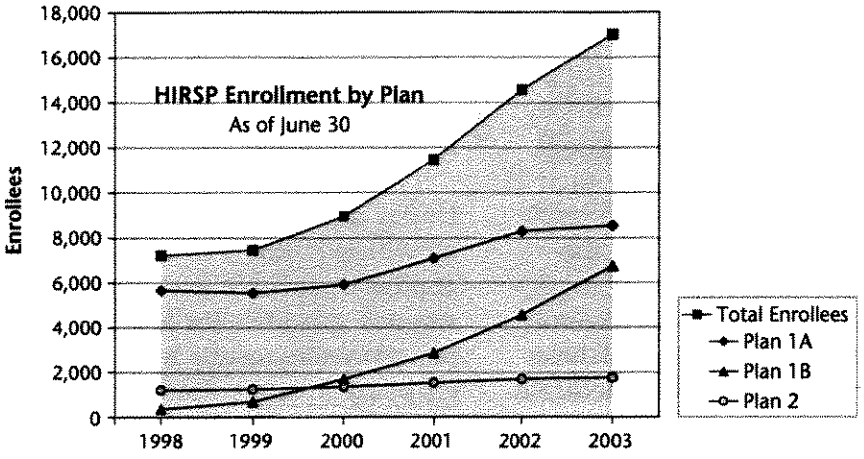
- to reduce policyholder premiums to the statutory minimum when the policyholders' share of costs would otherwise require a premium increase;
- for other needs of eligible persons, with the approval of the Board of Governors; or
- for distribution to eligible persons.

Increasing Enrollment and Claims Costs

Increasing enrollment and claims costs present continuing challenges to the management and funding of HIRSP.

Policyholder enrollment increased 6.9 percent during FY 2002-03, to 17,017 policyholders as of June 30, 2003. However, enrollment experience during the first eight months of FY 2003-04 suggests that enrollment growth may be beginning to slow: enrollment increased by 3.8 percent, to 17,669 as of February 29, 2004.

Enrollment in plans 1A and 2 began to level off in FY 2002-03, although enrollment in plan 1B continued to increase steadily. Further, an increasing number of participants have shifted from plan 1A to plan 1B in recent years. The greatest shift occurred in 2003, when 713 participants changed from plan 1A to plan 1B.



Net of health care providers' discounts, claims costs increased 171.1 percent, or $54.2 million, over the last five years. A large portion of these increases can be explained by the enrollment increases, although HIRSP claims costs also have been affected by medical cost increases similar to those experienced by others in the health insurance industry.

Claims Costs[1]

Fiscal Year	Amount	Percentage Change
1998-99	$31,671,704	–
1999-2000	36,399,671	14.9%
2000-01	54,120,507	48.7
2001-02	67,180,778	24.1
2002-03	85,849,897	27.8

[1]Net of health care providers' discounts.

Legislative Activity

The Legislature began providing GPR funding to offset program costs in FY 1997-98. At that time, GPR funding to subsidize premiums and deductibles for low-income policyholders had been in place for several years. During the 2001-03 biennium, GPR support for HIRSP totaled $21.0 million.

Under 2003 Wisconsin Act 33, the 2003-05 Biennial Budget Act, all GPR support for HIRSP was eliminated beginning in FY 2003-04. The other funding parties—policyholders, insurers, and health care providers—are now required to pay for costs that had previously been funded through GPR.

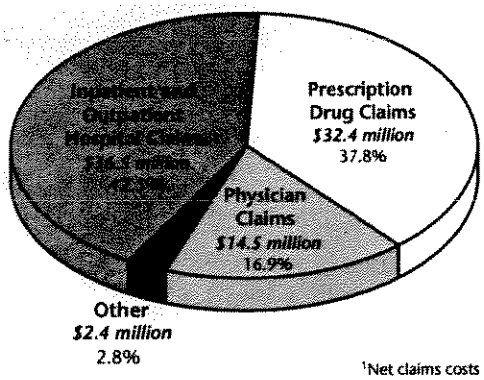
Act 33 also authorizes DHFS to select the HIRSP plan administrator through a competitive procurement process. Since 1998, statutes had required that the Medicaid fiscal agent serve as HIRSP's administrator. DHFS is currently conducting a competitive procurement process with the intent of selecting and contracting with a vendor to administer HIRSP beginning in January 2005, after a six-month transition period.

In light of HIRSP's increasing costs and the loss of GPR, legislation was introduced in February 2004 to expand the funding base to include drug manufacturers and drug labelers, which are companies that repackage prescription drugs for retail sale.

Under 2003 Senate Bill 466, which was not enacted, each manufacturer or labeler that provided prescription drugs under HIRSP would have been required to pay an annual assessment based on claims that HIRSP paid for their drugs in the previous calendar year. On a per claim basis, the assessment amount would have been equal to the rebate amount the drug manufacturer or labeler pays for the drug under Medicaid.

At 37.8 percent of net claims paid during FY 2002-03, prescription drug claims represent the second-largest portion of HIRSP's claims costs. HIRSP currently receives some drug rebates as part of the agreement with its plan administrator, including $677,118 during FY 2002-03.

Types of Claims Paid During FY 2002-03[1]



[1]Net claims costs totaled $85.8 million.

Technical Statutory Issue

DHFS and HIRSP's contracted actuary have identified a technical statutory issue that will require legislative action.

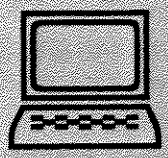
Under current statutes, the method by which HIRSP's funding formula applies deductible and drug coinsurance subsidies for low-income policyholders results in policyholders being over-credited for subsidies they did not fund, and a related portion of costs not being allocated to any funding party.

DHFS and the Board of Governors decided in 2001 that $1.5 million of unallocated costs associated with the deductible subsidy credit would be paid by policyholders, insurers, and health care providers based on the statutory funding split used for HIRSP costs. These costs had accumulated during 1998, 1999, and 2000.

In March 2004, the Board's Financial Oversight Committee approved a recommendation to the Board to reduce the excess policyholder premium account by the amount of over-credited deductible subsidies as of March 31, 2004. The unallocated balance was $2.1 million as of February 29, 2004. DHFS and the Board of Governors plan to pursue statutory changes to address this technical issue during the 2005-07 legislative session.

Additional Information

For a copy of report 04-3, which includes a response from the Department of Health and Family Services, call **(608) 266-2818** or visit our Web site:



www.legis.state.wi.us/lab

Address questions regarding this report to:

Diann Allsen
(608) 266-2818

Legislative Audit Bureau

22 East Mifflin Street
Suite 500
Madison, WI 53703
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Janice Mueller
State Auditor

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STATE OF WISCONSIN

Report 04-3
April 2004

An Audit

Health Insurance Risk-Sharing Plan

Department of Health and Family Services

04-3
April 2004

An Audit

Health Insurance Risk-Sharing Plan

Department of Health and Family Services

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State Auditor - Janice Mueller

Audit Prepared by

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CONTENTS

State of Wisconsin \ LEGISLATIVE AUDIT BUREAU

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April 14, 2004

Senator Carol A. Roessler and
Representative Suzanne Jeskewitz, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Roessler and Representative Jeskewitz:

At the request of the Department of Health and Family Services (DHFS), we have completed a financial audit of the Health Insurance Risk-Sharing Plan (HIRSP) for fiscal year (FY) 2002-03. HIRSP provides medical and prescription drug insurance for more than 17,000 policyholders who are unable to obtain coverage in the private market or who lost employer-sponsored group health insurance. We have provided an unqualified opinion on HIRSP's financial statements.

HIRSP's financial position continues to improve: its accounting deficit was $0.9 million on June 30, 2003, compared to $6.0 million on June 30, 2002. In addition, a balance in the excess policyholder premium account increased significantly during FY 2002-03, from $3.0 million to $10.4 million as of June 30, 2003. By statute, the excess premium balance can be used only for purposes that benefit policyholders, such as for reducing premium levels to a statutory floor of 140 percent of standard risk rates.

Despite an improving financial position, HIRSP faces continuing management and funding challenges because of increasing enrollment and claims costs. In FY 2002-03, enrollment increased 16.9 percent and claims costs increased 27.8 percent. In addition, general purpose revenue (GPR) support was eliminated beginning in FY 2003-04. Costs previously covered by GPR, which totaled $10.2 million in FY 2002-03, are now covered by policyholders, insurers, and health care providers. Further, legislative action will be needed to address a technical issue that DHFS and HIRSP's contracted actuary have identified in HIRSP's statutory funding formula.

During our prior audit, we recommended DHFS increase its oversight of prescription drug claims, which totaled $32.4 million in FY 2002-03, through independent audits of the pharmacy benefit management company's controls. DHFS is currently conducting a competitive procurement process to select the plan administrator that will be administering HIRSP beginning in January 2005, and it has included a requirement for such audits in the Request for Vendor Proposals that will be used to award a new contract.

We appreciate the courtesy and cooperation extended to us by DHFS and the plan administrator for HIRSP. A response from DHFS follows the appendix.

Respectfully submitted,

Janice Mueller
State Auditor

JM/DA/ss

Report Highlights ■

HIRSP's financial position improved during FY 2002-03.

Policyholder enrollment and claims costs continue to increase.

The 2003-05 Biennial Budget Act included changes to HIRSP.

A technical issue in HIRSP's statutory funding formula needs legislative attention.

The Health Insurance Risk-Sharing Plan (HIRSP) was established in 1980 to provide medical insurance for individuals who cannot obtain coverage in the private market because of the severity of their health conditions. In the late 1990s, it was also designated as Wisconsin's plan to meet federal Health Insurance Portability and Accountability Act (HIPAA) regulations and to provide health insurance to people who lose employer-sponsored group health insurance and meet other specified criteria.

HIRSP is primarily funded through policyholder premiums; financial assessments on health insurance companies that do business in Wisconsin; reduced reimbursements to health care providers; and, until recently, general purpose revenue (GPR). As of February 29, 2004, 17,669 policyholders were enrolled in HIRSP.

HIRSP offers eligible applicants three plans:

- The primary plan, plan 1A, is similar to coverage provided by many private major medical plans.
- The alternative plan, plan 1B, offers the same coverage as plan 1A but at lower premium rates because policyholders pay a higher deductible before HIRSP begins paying claims.
- An additional plan, plan 2, is available to Wisconsin residents under the age of 65 who participate in the federal Medicare program because of a disability.

At the request of the Department of Health and Family Services (DHFS), we completed our sixth financial audit of HIRSP. Our audit report contains our unqualified opinion on HIRSP's financial statements and related notes for the fiscal years ending June 30, 2003 and 2002.

Financial Status of the Plan

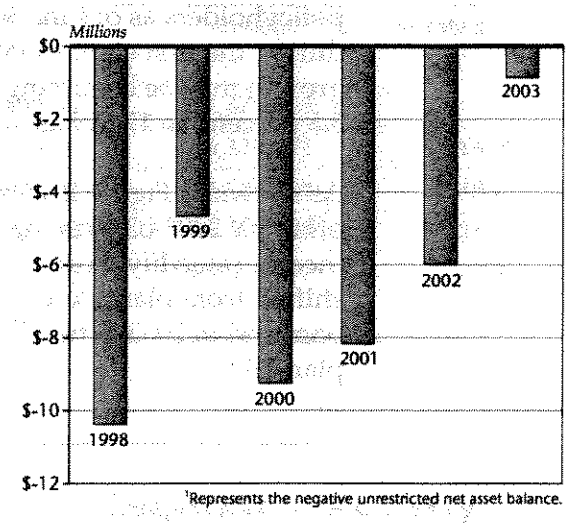
Because of its cash-based funding approach, HIRSP had an accounting deficit of $8.2 million as of June 30, 2001. This deficit represented estimated additional cash that HIRSP would eventually need to pay covered medical expenses that had been incurred but not paid before this date.

DHFS and HIRSP's Board of Governors implemented an accrual-based approach to funding HIRSP beginning with fiscal year (FY) 2001-02. An accrual basis takes into account the full costs associated with events that occur during a plan year, including actuarial cost estimates for incurred claims that may not be filed until after the plan year. The change to an accrual-based approach required funding to eliminate the accounting deficit that had accumulated under the cash-based approach, as well as funding for newly incurred costs accounted for on an accrual basis.

As a result of increasing enrollment and program costs, as well as the change in the funding approach, policyholder premiums and insurer assessments increased significantly during FY 2001-02 and FY 2002-03. Total premium revenue almost doubled, while insurer assessments increased 162.7 percent. The increased revenues that resulted from increases in premiums and insurer assessments contributed to a $5.1 million reduction in HIRSP's accounting deficit, which was $0.9 million as of June 30, 2003. Changes in the accounting deficit since June 30, 1998, are shown in Figure 1.

Figure 1

HIRSP's Accounting Deficit[1]
As of June 30



[1]Represents the negative unrestricted net asset balance.

Statutes require policyholders to fund 60 percent of HIRSP's costs and establish a floor for policyholder premiums of at least 150 percent of standard risk rates through July 29, 2002, and 140 percent of standard risk rates as of July 30, 2002. Statutes also require a separate accounting of premiums received in excess of the amount needed to cover policyholders' 60 percent share of HIRSP's costs.

Because the statutory floor level for premium rates has typically been greater than the premiums needed to fund 60 percent of HIRSP's costs, and because actual claims costs were less than costs assumed in HIRSP's FY 2002-03 budget, the excess policyholder premium account balance increased significantly during FY 2002-03, from $3.0 million to $10.4 million as of June 30, 2003.

The use of these funds is statutorily restricted for these purposes:

- to reduce policyholder premiums to the statutory minimum when the policyholders' share of costs would otherwise require a premium increase;
- for other needs of eligible persons, with the approval of the Board of Governors; or
- for distribution to eligible persons.

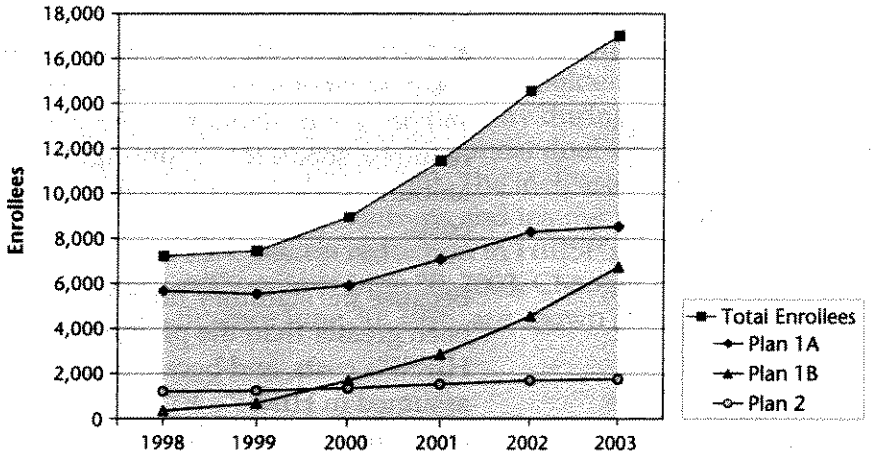
Increasing Enrollment and Claims Costs

Increasing enrollment and claims costs present continuing challenges to the management and funding of HIRSP. Policyholder enrollment increased 16.9 percent during FY 2002-03, to 17,017 policyholders as of June 30, 2003. However, enrollment experience during the first eight months of FY 2003-04 suggests that enrollment growth may be beginning to slow: enrollment increased by 3.8 percent, to 17,669 as of February 29, 2004.

As shown in Figure 2, enrollment in plans 1A and 2 began to level off in FY 2002-03, although enrollment in plan 1B continued to increase steadily. Further, an increasing number of participants have shifted from plan 1A to plan 1B in recent years. The greatest shift occurred in 2003, when 713 participants changed from plan 1A to plan 1B.

Figure 2

HIRSP Enrollment by Plan
As of June 30



Net of health care providers' discounts, claims costs increased 171.1 percent, or $54.2 million, over the last five years. A large portion of these increases, shown in Table 1, can be explained by the enrollment increases, although HIRSP claims costs also have been affected by medical cost increases similar to those experienced by others in the health insurance industry.

Table 1

Claims Costs[1]

Fiscal Year	Amount	Percentage Change
1998-99	$31,671,704	–
1999-00	36,399,671	14.9%
2000-01	54,120,507	48.7
2001-02	67,180,778	24.1
2002-03	85,849,897	27.8

[1] Net of health care providers' discounts.

Legislative Activity

The Legislature began providing GPR funding to offset program costs in FY 1997-98. At that time, GPR funding to subsidize premiums and deductibles for low-income policyholders had been in place for several years. During the 2001-03 biennium, GPR support for HIRSP totaled $21.0 million.

Under 2003 Wisconsin Act 33, the 2003-05 Biennial Budget Act, all GPR support for HIRSP was eliminated beginning in FY 2003-04. The other funding parties—policyholders, insurers, and health care providers—are now required to pay for costs that had previously been funded through GPR.

Act 33 also authorizes DHFS to select the HIRSP plan administrator through a competitive procurement process. Since 1998, statutes had required that the Medicaid fiscal agent serve as HIRSP's administrator. DHFS is currently conducting a competitive procurement process with the intent of selecting and contracting with a vendor to administer HIRSP beginning in January 2005, after a six-month transition period.

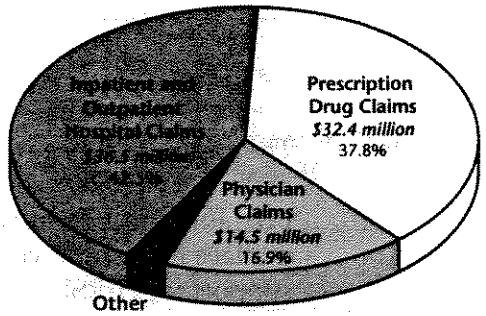
In light of HIRSP's increasing costs and the loss of GPR, legislation was introduced in February 2004 to expand the funding base to include drug manufacturers and drug labelers, which are companies that repackage prescription drugs for retail sale. Under 2003 Senate Bill 466, which was not enacted, each manufacturer or labeler that provided prescription drugs under HIRSP would have been required to pay an annual assessment based on claims that HIRSP

paid for their drugs in the previous calendar year. On a per claim basis, the assessment amount would have been equal to the rebate amount the drug manufacturer or labeler pays for the drug under Medicaid.

At 37.8 percent of net claims paid during FY 2002-03, prescription drug claims represent the second-largest portion of HIRSP's claims costs, as shown in Figure 3. HIRSP currently receives some drug rebates as part of the agreement with its plan administrator, including $677,118 during FY 2002-03.

Figure 3

Types of Claims Paid During FY 2002-03[1]



[1]Net claims costs totaled $85.8 million.

Technical Statutory Issue

DHFS and HIRSP's contracted actuary have identified a technical statutory issue that will require legislative action. Under current statutes, the method by which HIRSP's funding formula applies deductible and drug coinsurance subsidies for low-income policyholders results in policyholders being over-credited for subsidies they did not fund, and a related portion of costs not being allocated to any funding party.

DHFS and the Board of Governors decided in 2001 that $1.5 million of unallocated costs associated with the deductible subsidy credit would be paid by policyholders, insurers, and health care providers based on the statutory funding split used for HIRSP costs. These

costs had accumulated during 1998, 1999, and 2000. In March 2004, the Board's Financial Oversight Committee approved a recommendation to the Board to reduce the excess policyholder premium account by the amount of over-credited deductible subsidies as of March 31, 2004. The unallocated balance was $2.1 million as of February 29, 2004. DHFS and the Board of Governors plan to pursue statutory changes to address this technical issue during the 2005-07 legislative session.

■ ■ ■ ■

Introduction ■

DHFS has been responsible for overseeing HIRSP since 1998. The 13-member Board of Governors advises DHFS on HIRSP's operations and includes members representing insurers, health care providers, and the public. At least one member of the Board must be a HIRSP policyholder. While the Board fills an advisory and oversight role, DHFS retains program rule-making authority, establishes the annual budget, and currently contracts with the State's fiscal agent for Medicaid to administer HIRSP. However, 2003 Wisconsin Act 33 eliminated a requirement that the plan administrator be the Medicaid fiscal agent, and DHFS is currently conducting a competitive procurement process to select the HIRSP plan administrator for the period beginning in January 2005, after a six-month transition period.

At the request of DHFS, we completed a financial audit of HIRSP for FY 2002-03. As necessary parts of the financial audit, we reviewed HIRSP's control procedures, assessed the fair presentation of the FY 2002-03 financial statements, and reviewed compliance with statutory provisions.

Plan Provisions

Three plans are available to policyholders.

HIRSP offers eligible applicants three plans:

- Plan 1A is available for Wisconsin residents who have received a notice of rejection, cancellation, reduction of coverage, or substantial premium increase by an insurer; who have tested positive

for the virus that causes AIDS; or who have lost employer-sponsored group health insurance and meet other specified criteria.

- Plan 1B is an alternative plan that was introduced in 1998 to comply with a federal HIPAA requirement to offer a choice of major medical expense coverage to the same individuals eligible for the primary plan.

- Plan 2 is available to Wisconsin residents under the age of 65 who participate in the federal Medicare program because of a disability. Persons with coverage when they reach the age of 65 may continue in the plan.

By statute, HIRSP may reimburse only those medical services that policyholders obtain through the State's Medicaid-certified providers. In addition to annual premiums, policyholders are required to share in the costs of covered services through:

- annual medical deductibles of $1,000 for plan 1A, $2,500 for plan 1B, and $500 for plan 2, which must be paid by policyholders before insurance benefits will be available;

- medical coinsurance payments of 20 percent up to $1,000 per year for policyholders in plans 1A and 1B, which must be paid by the policyholders after their annual deductible requirements have been satisfied (there is no coinsurance requirement for plan 2); and

- drug coinsurance payments of 20 percent, or $25 maximum per drug, up to $750 for plan 1A, $1,000 for plan 1B, and $125 for plan 2.

Plan Funding

Before January 1, 1998, HIRSP had two primary funding sources: premiums paid by policyholders, and annual financial assessments on health insurance companies that do business in Wisconsin. 1997 Wisconsin Act 27 authorized additional funding sources that took effect when oversight responsibility was transferred to DHFS on January 1, 1998. At the time, the Legislature:

- made additional GPR funding available to offset program costs, including $10.0 million in FY 2001-02 and $9.5 million in FY 2002-03; and

- required providers of covered health care items and services to share equally with insurers in program costs that were not covered by premiums and GPR. By statute, pharmacies have been excluded from the funding requirement for providers.

GPR support for HIRSP, which totaled $21.0 million in the 2001-03 biennium, has been eliminated.

Until recently, the Legislature also continued GPR support to help fund premium and deductible subsidies for low-income policyholders. This support included $780,800 in GPR for FY 2001-02, and $741,800 for FY 2002-03. Insurers and health care providers shared equally in the subsidy costs that were not covered by GPR, which totaled $3.9 million during FY 2002-03. GPR support for HIRSP totaled $21.0 million in the 2001-03 biennium, but all GPR support was eliminated beginning in FY 2003-04.

Under HIRSP's complex statutory funding formula, which is illustrated in the appendix, policyholder premiums are required to fund 60 percent of the estimated operating and administrative costs. The remaining 40 percent are funded equally by private health insurers doing business in Wisconsin and health care providers providing medical services to HIRSP policyholders.

Premium rates for each of HIRSP's three plans differ on the basis of policyholders' gender, age, and geographic location and may range from not less than 140 percent to not more than 200 percent of standard rates. On average, premium rates for the primary plan have been at the minimum level, which was 150 percent of standard rates from January 1, 1998 through June 30, 2003, and 140 percent of standard rates since July 1, 2003. However, they were 161.9 percent of standard rates in FY 2001-02.

Rate increases for both plan 1A and plan 1B have been generally comparable to increases in the standard risk rates that private insurers would charge for individual insurance policies that provide substantially the same coverage and deductibles available under HIRSP. Table 2 shows premium rate changes since 1998. Plan 2, which is available for certain Medicare participants, typically experienced larger rate increases to more closely reflect that plan's claims costs. In response to concerns about increases in premiums for plan 2, statutes allow DHFS to consider enrollment levels and other economic factors in addition to claims costs when establishing premium levels. The ultimate goal of DHFS and the Board of Governors is to make the ratio of losses to premiums more consistent for all plans and to reduce the extent to which plans 1A and 1B are subsidizing plan 2.

Table 2

Premium Rate Changes

Effective Date	Plans 1A and 1B	Plan 2
July 1, 1998	11.4% increase	24.0% increase
January 1, 1999	No change	10.0% increase
July 1, 1999	No change	4.0% increase
July 1, 2000	12.4% increase	18.2% increase
July 1, 2001	3.4% increase	3.4% increase
July 1, 2002	25.4% increase	30.8% increase
July 1, 2003	10.6% increase	15.6% increase

Examples of annual premiums effective July 1, 2003, for policyholders living in Milwaukee, where the rates are the highest, are shown in Table 3.

Table 3

Examples of Annual Premiums for a Policyholder Living in Milwaukee
Rates Effective July 1, 2003

Plan Type	Male Ages 0-24	Male Ages 60-64	Female Ages 0-18	Female Ages 60-64
Plan 1A	$2,232	$10,836	$2,232	$8,904
Plan 1B	1,608	7,800	1,608	6,408
Plan 2	1,716	8,280	1,716	6,804

In FY 2002-03, 23.7 percent of HIRSP policyholders received subsidies, at a cost of $4.6 million.

Policyholders who are enrolled in plan 1A or plan 2 and who have annual household incomes below $25,000 are eligible for premium subsidies. Policyholders enrolled in plan 1A with annual household incomes below $20,000 are also eligible for deductible subsidies. Beginning January 1, 2002, plan 1A policyholders who are eligible for deductible subsidies are also eligible for drug coinsurance subsidies. In FY 2002-03, 23.7 percent of HIRSP policyholders received subsidies, at a cost of $4.6 million.

DHFS and HIRSP's contracted actuary identified a technical issue relating to the treatment of deductible and drug coinsurance subsidies in the statutory funding formula. When the formula is applied, deductible and drug coinsurance subsidies are appropriately excluded from the costs that are allocated among all funding parties. The subsidies are then appropriately funded by insurers and providers. However, statutes also require that the subsidies be credited to policyholders when premiums are calculated. Therefore, deductible and drug coinsurance subsidy amounts are, in essence, double counted under the statutory funding formula; policyholders are inappropriately credited for subsidies each year; and, as result, a portion of HIRSP's annual costs is not allocated to any funding party.

DHFS and the Board of Governors decided in 2001 that $1.5 million of unallocated costs associated with the deductible subsidy credit would be paid by policyholders, insurers, and health care providers based on the statutory funding split used for HIRSP costs. These costs had accumulated during 1998, 1999, and 2000. In March 2004, the Board's Financial Oversight Committee approved a recommendation to the Board to reduce the excess policyholder premium account by the amount of over-credited deductible subsidies as of March 31, 2004. The unallocated balance was $2.1 million as of February 29, 2004. DHFS and the Board of Governors also plan to pursue statutory changes to address this technical issue during the 2005-07 legislative session.

▪▪▪▪

Audit Opinion ■

Independent Auditor's Report on the Financial Statements of the Wisconsin Health Insurance Risk-Sharing Plan

We have audited the accompanying financial statements of the Wisconsin Health Insurance Risk-Sharing Plan (HIRSP) as of and for the years ended June 30, 2003 and 2002. These financial statements are the responsibility of the Department of Health and Family Services' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements referred to in the first paragraph present only HIRSP and do not purport to, and do not, present fairly the financial position of the State of Wisconsin and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of HIRSP as of June 30, 2003 and 2002, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 14, HIRSP implemented a new financial reporting model for fiscal year 2001-02, as required by the provisions of Governmental Accounting Standards Board Statement Number 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.

Our audits were conducted for the purpose of forming an opinion on the financial statements of HIRSP. The supplementary information included as Management's Discussion and Analysis on pages 19 through 24 is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 2, 2004, on our consideration of HIRSP's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

LEGISLATIVE AUDIT BUREAU

April 2, 2004

Diann Allsen
Audit Director

Management's Discussion and Analysis ■

Prepared by the Health Insurance Risk-Sharing Plan's Management

This section of the HIRSP annual financial report presents management's discussion and analysis of the financial performance of HIRSP. This discussion should be read in conjunction with the accompanying financial statements and notes. The financial statements, notes, and this discussion are the responsibility of HIRSP's management.

HIRSP was established in 1980. The purpose of HIRSP is to provide medical and prescription drug insurance for persons unable to obtain this insurance in the private market or who otherwise qualify for eligibility under s. 149.12, Wis. Stats.

Overview of Financial Statements

HIRSP prepares its financial statements in accordance with Governmental Accounting Standards Board (GASB) standards. For the fiscal year ended June 30, 2002, HIRSP implemented GASB Statement Number 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.

HIRSP's financial statements comprise two components: 1) the financial statements, and 2) notes to the financial statements that explain in more detail some of the information in the financial statements.

Following this section are the financial statements and notes as they relate to HIRSP.

- The Balance Sheet provides information on the types of assets and the liabilities of HIRSP, with the differences between the two reported as net assets. Over time, increases or decreases in net assets are an indicator of HIRSP's financial health.

- The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and the expenses incurred during the year on an accrual basis.

- The Statement of Cash Flows presents information related to cash inflows and outflows summarized by operating, noncapital financing, and investing activities and helps measure HIRSP's ability to meet financial obligations as they mature.

- The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. HIRSP uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. During FY 2002-03, the plan had two funding types: general purpose revenue (GPR), and program income in the form of segregated (SEG) funds.

For fiscal years ending June 30, 1998 through June 30, 2003, GPR revenues were received by HIRSP from the State of Wisconsin for general plan funding, as well as for premium and deductible subsidies for low-income policyholders. Prior to FY 1997-98, GPR funding was only available for premium and deductible subsidies. Starting in FY 2003-04, no GPR funding was appropriated for HIRSP for either general plan funding or premium and deductible subsidies for low-income policyholders.

Program income is received by HIRSP from policyholders and insurers. Health care providers contribute to HIRSP by accepting a reduction in fees for their services. Section 149.143, Wis. Stats., prescribes a funding formula for HIRSP that requires policyholders, private health insurers, and health care providers, except pharmacies, to share in plan costs remaining after GPR appropriated under s. 20.435(4)(af), Wis. Stats., is deducted. Pharmacies are specifically exempt from contributing to HIRSP as provided by s. 149.142(1)(b), Wis. Stats.

Premiums, which before July 30, 2002, were statutorily required to be at least 150 percent of standard risk rates, are to fund 60 percent of these estimated costs, as long as the necessary premium rates do not exceed 200 percent of standard risk rates. 2001 Wisconsin Act 109 lowered the minimum premium level from 150 percent to 140 percent of the standard risk rate, effective July 30, 2002. Private health insurers doing business in Wisconsin and health care providers (except pharmacies) providing medical services to HIRSP policyholders are to share equally in:

- costs remaining after any GPR appropriated under s. 20.435(4)(af), Wis. Stats., and after the deduction of the policyholders' share of the costs;

- premium, deductible, and drug coinsurance subsidy costs in excess of any GPR appropriated under s. 20.435(4)(ah), Wis. Stats., for that purpose; and

- excess costs when premium rates needed to fund 60 percent of costs exceed 200 percent of premium rates for standard risks. However, between FY 1997-98 and FY 2003-04, the highest HIRSP rates have been 161.9 percent of the standard risk rate.

Financial Analysis of HIRSP

In this discussion and analysis, the reasons for the changes in financial activity between FY 2002-03 and FY 2001-02 are reviewed. Net assets may serve over time as a useful indicator of the financial position of HIRSP. In the case of HIRSP, assets exceeded liabilities by $9,530,521 at the close of the fiscal year ending June 30, 2003, an improvement of $12,496,044 over total net assets as of June 30, 2002.

Condensed Financial Information

	June 30, 2003	June 30, 2002	Percentage Change
Total Assets	$42,058,260	$27,540,481	52.7%
Total Liabilities	32,527,739	30,506,004	6.6
Net Assets:			
Restricted	10,418,274	3,040,220	242.7
Unrestricted	(887,753)	(6,005,743)	85.2
Total Net Assets	**$9,530,521**	**$(2,965,523)**	421.4

	FY 2002-03	FY 2001-02	Percentage Change
Operating Revenues	$92,371,493	$62,995,554	46.6%
Operating Expenses	(90,462,180)	(71,069,074)	27.3
Nonoperating Revenues	10,586,731	11,153,426	(5.1)
Change in Net Assets	**$12,496,044**	**$ 3,079,906**	305.7

The largest portion of HIRSP's total assets, 95.7 percent, is in the form of cash and cash equivalents. HIRSP uses cash to pay current operating expenses. Cash in excess of immediate needs is invested in short-term investments with the State of Wisconsin Investment Board.

The largest area of HIRSP's liabilities is unpaid loss liabilities. Unpaid loss liabilities represent the accumulation of losses, net of discounts from providers, that were reported but not paid prior to the close of the accounting period, and an actuarial estimate of claims incurred prior to June 30 but not reported. Consequently, cash is reserved for payment of these future claims.

HIRSP's net assets increased by $12,496,044 during FY 2002-03. Net assets restricted for excess policyholder premiums accounted for $7,378,054 of this increase. HIRSP's revenues consist of GPR funds, policyholder premiums, and insurer assessments. HIRSP uses these revenues to pay operating expenses. HIRSP revenues, combined with reduced payments to health care providers, were sufficient to cover all operating expenses of the program during FY 2002-03.

Financial Highlights

- Plan enrollment as of June 30, 2003, was 17,017, an increase of 16.9 percent over June 30, 2002 enrollment of 14,563. As a result of the enrollment increase:
  - Premium revenues increased.
  - Insurer assessments increased.
  - Claims expense (net of health care providers' discounts) increased.
- Revenue from the State of Wisconsin decreased 5.0 percent.
- Plan operations are conducted by DHFS staff, as well as a third-party contract administrator.
  - Total administrative costs for FY 2002-03 were $4,460,955, up 17.9 percent from $3,784,699 in FY 2001-02.
  - Total administrative costs were 4.9 percent of program costs for FY 2002-03, a decrease from 5.3 percent of program costs for FY 2001-02.
  - The following chart shows plan costs for claims and administrative expenses on a per member per month (PMPM) basis:

Cost Summary on a per Member per Month (PMPM) Basis
FY 2001-02 and FY 2002-03

Description	FY 2001-02	FY 2002-03	FY 2001-02 PMPM	FY 2002-03 PMPM	Percentage Change
Member Months (Total Members Enrolled in Each Month of Fiscal Year)	157,970	192,654	–	–	22.0%
Gross Claims (Costs before Provider Contributions Were Deducted)	$82,938,495	$112,009,977	$525.03	$581.40	10.7 %
Administrative Expenses	$ 3,784,699	$ 4,460,955	$ 23.96	$ 23.16	-3.3 %

- HIRSP's change in net assets increased.
  - The change in net assets was $12,496,044, an improvement of over $9.4 million from the $3,079,906 change in FY 2001-02.
  - Investment income declined from $372,626 in FY 2001-02 to $349,551 in FY 2002-03, largely due to continued declining investment returns.
- Net assets are split between restricted and unrestricted.
  - Restricted net assets for excess policyholder premiums increased from $3,040,220 to $10,418,274. This increase of $7,378,054 was primarily the result of actual claim expenses being less than anticipated at the time the budget was set, and the premium floor being at 150 percent of standard risk rates for the fiscal year. The restricted net assets are statutorily required under s. 149.143(2m)(b), Wis. Stats., to be used 1) to reduce policyholder premiums to a floor of 150 percent (140 percent effective July 30, 2002) of standard risk rates when premiums exceed the policyholders' share of plan costs; 2) for other needs of eligible persons, with the approval of the Board of Governors; or 3) for distribution to eligible persons.

- Unrestricted net assets improved as well, from ($6,005,743) to ($887,753). Unrestricted net assets represent the estimated amount of additional cash that HIRSP would need to pay its liabilities as of fiscal year-end.

Contacting the Plan's Financial Management

The financial report is designed to provide a general overview of HIRSP finances for all those with an interest. Questions concerning any of the information provided in this report, or requests for additional information, should be addressed to:

Sally A. Acuff, Audit Liaison
Department of Health and Family Services
Room 655, 1 West Wilson Street
P.O. Box 7850
Madison, WI 53707-7850

General information relating to HIRSP can be found at the HIRSP Web site, *http://www.dhfs.state.wi.us/hirsp/index.htm.*

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Financial Statements ■

Balance Sheet
June 30, 2003 and 2002

	June 30, 2003	Restated June 30, 2002
ASSETS		
Cash and Cash Equivalents (Note 2)	$ 40,264,885	$ 24,958,974
Assessments Receivable (Note 3)	167,035	278,103
Other Receivables (Note 3)	1,543,300	2,244,142
Prepaid Items	83,040	59,262
TOTAL ASSETS	**$ 42,058,260**	**$ 27,540,481**
LIABILITIES AND NET ASSETS		
Liabilities:		
Unpaid loss liabilities (Note 4)	$ 14,887,195	$ 14,674,153
Unpaid loss adjustment expenses (Note 4)	660,000	621,900
Unearned premiums	13,609,566	10,470,731
Liability for premium overpayments (Note 5)	471,488	471,488
Accounts payable and other accrued liabilities (Note 3)	2,899,490	4,267,732
Total Liabilities	**32,527,739**	**30,506,004**
Net Assets:		
Restricted for excess policyholder premiums (Notes 6 and 15)	10,418,274	3,040,220
Unrestricted (Notes 12 and 15)	(887,753)	(6,005,743)
Total Net Assets	**9,530,521**	**(2,965,523)**
TOTAL LIABILITIES AND NET ASSETS	**$ 42,058,260**	**$ 27,540,481**

The accompanying notes are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Net Assets for the Years Ended June 30, 2003 and 2002

	For the Year Ended June 30, 2003	For the Year Ended June 30, 2002
OPERATING REVENUES		
Premiums	$ 66,368,223	$ 43,375,232
Insurers' Assessments (Note 7)	26,003,270	19,620,322
Total Operating Revenues	**92,371,493**	**62,995,554**
OPERATING EXPENSES		
Losses:		
Losses paid or approved for payment (Note 11)	84,283,858	70,627,947
Increase (decrease) in unpaid losses	1,566,039	(3,447,169)
Total Losses	**85,849,897**	**67,180,778**
Change in Unpaid Loss Adjustment Expenses	38,100	0
General and Administrative Expenses (Note 10)	4,460,955	3,784,699
Referral Fees	113,228	103,597
Total Operating Expenses	**90,462,180**	**71,069,074**
OPERATING INCOME (LOSS)	**1,909,313**	**(8,073,520)**
NONOPERATING REVENUES AND EXPENSES		
Revenue from the State of Wisconsin	9,500,000	10,000,000
State Premium and Deductible Subsidies (Note 9)	741,800	780,800
Investment Income	349,551	372,626
Transfer to the General Fund	(4,620)	0
Total Nonoperating Income	**10,586,731**	**11,153,426**
CHANGE IN NET ASSETS	**12,496,044**	**3,079,906**
NET ASSETS		
Total Net Assets—Beginning of the Year	(2,965,523)	(6,045,429)
Total Net Assets—End of the Year	**$ 9,530,521**	**$ (2,965,523)**

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2003 and 2002

	For the Year Ended June 30, 2003	For the Year Ended June 30, 2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received for Premiums	$ 70,356,312	$ 46,728,384
Cash Received for Assessments	26,114,337	19,377,658
Cash Payments for Losses	(87,071,251)	(66,910,922)
Cash Payments for Other Expenses	(4,684,838)	(4,029,249)
Net Cash Provided (Used) by Operating Activities	**4,714,560**	**(4,834,129)**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Cash Received from the State of Wisconsin	10,241,800	10,780,800
Net Cash Provided by Noncapital Financing Activities	**10,241,800**	**10,780,800**
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Income	349,551	372,626
Net Cash Provided by Investing Activities	**349,551**	**372,626**
NET INCREASE IN CASH AND CASH EQUIVALENTS	**15,305,911**	**6,319,297**
Cash and Cash Equivalents—Beginning of the Year	24,958,974	18,639,677
Cash and Cash Equivalents—End of the Year	$ 40,264,885	$ 24,958,974
RECONCILIATION OF NET OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Net Operating Income (Loss)	$ 1,909,313	$ (8,073,520)
Adjustments to Reconcile Net Operating Loss to Net Cash Provided by Operating Activities:		
Changes in assets and liabilities:		
Decrease (increase) in receivables	811,910	2,311,484
Decrease (increase) in prepaids	(23,778)	(50)
Increase (decrease) in liability for premium overpayments	0	471,488
Increase (decrease) in accounts payable	(1,368,242)	(101,760)
Increase (decrease) in unearned premiums	3,138,835	3,052,235
Increase (decrease) in loss liabilities	251,142	(2,494,006)
Other adjustments	(4,620)	0
Total Adjustments	2,805,247	3,239,391
Net Cash Used by Operating Activities	**$ 4,714,560**	**$ (4,834,129)**

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements ■

1. Summary of Significant Accounting Policies

A. Description of the Fund

The Wisconsin Health Insurance Risk-Sharing Plan (HIRSP), which is part of the State of Wisconsin financial reporting entity and is reported as an enterprise fund in the State's Comprehensive Annual Financial Report, was established in 1980. The purpose of HIRSP is to provide medical insurance for persons unable to obtain this insurance in the private market or who otherwise qualify for eligibility under s. 149.12, Wis. Stats.

Effective January 1, 1998, HIRSP was transferred from the State of Wisconsin Office of the Commissioner of Insurance to the State of Wisconsin Department of Health and Family Services (DHFS). DHFS uses independent third-party administrators to provide underwriting, claims settlement, actuarial, and administrative services.

Section 149.143, Wis. Stats., prescribes a funding formula for HIRSP that requires policyholders, private health insurers, and health care providers to share in estimated costs remaining after general purpose revenue (GPR) appropriated under s. 20.435(4)(af), Wis. Stats., is deducted. Plan 1A and 1B premiums, which before July 30, 2002, were statutorily required to be at least 150 percent of standard risk rates, are to fund 60 percent of these estimated costs, as long as the necessary premium rates do not exceed 200 percent of standard risk rates. 2001 Wisconsin Act 109 lowered the minimum premium level from 150 percent to 140 percent of the standard risk rate, effective July 30, 2002. Plan 2

premiums are established using criteria outlined in s. 149.14 5(m), Wis. Stats.: 1) comparison of cost per capita for plans 1A and 2 in the previous calendar year; 2) enrollment levels of eligible persons in plans 1A and 2; and 3) economic factors DHFS and the Board of Governors consider relevant.

Private health insurers doing business in Wisconsin and health care providers providing medical services to HIRSP policyholders are to share equally in:

- costs remaining after any GPR appropriated under s. 20.435(4)(af), Wis. Stats., and after the deduction of the policyholders' share of the costs;
- premium, deductible, and drug coinsurance subsidy costs in excess of any GPR appropriated under s. 20.435(4)(ah), Wis. Stats., for that purpose; and
- excess costs when premium rates needed to fund 60 percent of costs exceed 200 percent of premium rates for standard risks.

B. Basis of Presentation and Accounting

The accompanying financial statements of HIRSP have been prepared in conformity with generally accepted accounting principles for governments as prescribed by the Governmental Accounting Standards Board (GASB).

The accompanying financial statements were prepared based upon the flow of economic resources measurement focus and the full accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the accounting period in which they are earned and become measurable, and expenses are recognized in the period incurred if measurable. Financial Accounting Standards Board statements effective after November 30, 1989, are not applied in accounting for HIRSP's operations.

Operating revenues and expenses are directly related to the ongoing medical insurance activities of HIRSP. Nonoperating revenues and expenses are indirectly related to the ongoing medical insurance activities of HIRSP, such as investment income. Certain significant revenue streams relied upon by operations are reported as nonoperating revenue, as defined by GASB Statement Number 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, including state general appropriations.

C. Accounting Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ

from those estimates. Estimates that are particularly susceptible to significant change are the unpaid loss liabilities as described in Notes 1E and 4 and the provider contributions as described in Note 11. In estimating these items, management used the methodologies discussed in the applicable notes.

D. Cash and Cash Equivalents

Cash and cash equivalents reported on the Balance Sheet and the Statement of Cash Flows include a demand deposit account at a commercial financial institution and cash deposited with the State Treasurer, where available balances beyond immediate needs are pooled in the State Investment Fund for short-term investment purposes. Balances pooled are restricted to legally stipulated investments. These investments are valued consistent with GASB Statement Number 31, Accounting and Financial Reporting for Investments and for External Investment Pools.

E. Unpaid Loss Liabilities

Unpaid loss liabilities represent the accumulation of losses, net of discounts to provider payments, reported but not paid prior to the close of the accounting period and estimates of claims incurred prior to June 30 but not reported. The unpaid loss liabilities are established by an independent actuary and are based on historical patterns of claim payments. Such liabilities are necessarily based on estimates and, while management believes the results of the estimates are materially correct, the ultimate liabilities may be in excess or less than the amounts provided due to uncertainties inherent in the estimation process. The method and assumptions used in making such estimates are periodically reviewed and updated, with resulting adjustments to the liabilities reflected in current operations. The unpaid loss adjustment expense is the anticipated cost for processing claims related to the unpaid loss liabilities.

F. Premium and Assessment Revenue

Premiums are recognized as revenues over the terms of the insurance policies, and a liability for unearned premiums is established to reflect premiums received applicable to subsequent accounting periods. Participating insurers are assessed every six months, and revenue is recognized over the period covered by the assessment. Insurer assessments are determined annually during the budgeting process and split into two installments.

G. Policy Acquisition Costs

HIRSP has no marketing staff and incurs no sales commissions. Policy acquisition costs are minimal and expensed as incurred. Insurance agents who assist individuals with the HIRSP application process are paid a one-time referral fee in the amount of $35 for each policy issued.

2. DEPOSITS

GASB Statement Number 3 requires deposits with financial institutions to be categorized to indicate the level of risk assumed by the State at year-end. The risk categories for deposits are:

- category 1: insured or collateralized with securities held by HIRSP or by its agent in HIRSP's name;
- category 2: uninsured but collateralized by the financial institution; and
- category 3: uninsured and uncollateralized.

HIRSP's cash balances are maintained in a public funds checking account with a commercial financial institution and with the State of Wisconsin Investment Board. The carrying amount of the demand deposits with the financial institution was $1,256,659 at June 30, 2003, and $897,099 at June 30, 2002. The bank balance was $1,252,504 at June 30, 2003, and $1,516,084 at June 30, 2002. The Federal Deposit Insurance Corporation and the Wisconsin State Deposit Guarantee Fund (s. 34.08, Wis. Stats.) cover state deposits. Of the bank balance at June 30, 2003, and June 30, 2002, $400,000 was insured and classified in risk category 1; $852,504 at June 30, 2003, and $1,116,084 at June 30, 2002, was uninsured and uncollateralized and was classified in risk category 3.

The State of Wisconsin Investment Board, through the State Investment Fund, invests cash deposited with the State of Wisconsin Treasurer. The carrying amount of shares in the State Investment Fund, which approximates market value, was $38,674,192 as of June 30, 2003, and $23,679,096 as of June 30, 2002.

Holdings of the State Investment Fund include certificates of deposit and investments consisting primarily of direct obligations of the federal government and the State, and unsecured notes of qualifying financial and industrial issuers. Shares in the State Investment Fund are not required to be categorized under GASB Statement Number 3. The State Investment Fund is not registered with the Securities and Exchange Commission.

3. RECEIVABLE AND PAYABLE DETAIL

Significant receivable balances as of June 30, 2003, include the following:

Assessments Receivable	$ 167,035
Other Receivables:	
Drug Rebates	571,544
Claims Receivable	424,009
Due from the State of Wisconsin	418,324
Miscellaneous Receivables	129,423
Total	$1,543,300