

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

September 30, 2013

**Table of Contents**

<b>Description</b>	<b>Page No.</b>
Independent Auditors' Report .....	1
Management's Discussion and Analysis (Unaudited).....	3
Basic Financial Statements:	
Statement of Net Position .....	7
Statement of Revenues, Expenses, and Changes in Net Position .....	8
Statement of Cash Flows .....	9
Notes to Financial Statements .....	10
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 <i>Government Auditing Standards</i> .....	18



KPMG LLP  
Suite 12000  
1801 K Street, NW  
Washington, DC 20006

## **Independent Auditor's Report**

Executive Director and Board of Directors of the  
District of Columbia Health Benefit Exchange Authority  
Inspector General of the Government of the District of Columbia

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the District of Columbia Health Benefit Exchange Authority (the Authority), a component unit of the Government of the District of Columbia, which comprise the statement of financial position as of September 30, 2013, 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, which collectively comprise the Authority'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 of material misstatement.

An audit includes 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 the District of Columbia Health Benefit Exchange Authority as of September 30, 2013, and the changes in its financial position and its cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.

### ***Other Matters***

#### ***Required Supplementary Information***

U.S. generally accepted accounting principles require that the management's discussion and analysis as listed in the table of contents, 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.

#### ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated February 18, 2014 on our consideration of the Authority'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 the Authority's internal control over financial reporting and compliance.

KPMG LLP

February 18, 2014

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

**Management's Discussion and Analysis**

**September 30, 2013**

**Unaudited**

**Introduction**

The following is a discussion and analysis of the District of Columbia Health Benefit Exchange Authority's (HBX's) financial performance for the fiscal year ended September 30, 2013. This information should be read in conjunction with the financial statements and the accompanying note disclosures, which follow this discussion and analysis.

**Background of the Health Benefit Exchange Authority**

Pursuant to the Health Benefit Exchange Authority Establishment Act of 2011, HBX was established as an independent authority of the Government of the District of Columbia (District of Columbia) with a legally separate existence. HBX was established to: (a) enable individuals and small employers to find affordable and easier-to-understand health insurance; (b) facilitate the purchase and sale of qualified health plans; (c) assist small employers in facilitating the enrollment of their employees in qualified health plans; (d) reduce the number of uninsured; (e) provide a transparent marketplace for health benefit plans; (f) educate consumers; and (g) assist individuals and groups in accessing programs, premium assistance tax credits, and cost-sharing reductions.

HBX is governed by an 11-member Executive Board, comprised of seven voting members, who are residents of the District of Columbia, appointed by the Mayor with the advice and consent of the Council of the District of Columbia (Council); and four nonvoting, ex-officio members, or their designees, which include the Director of the District of Columbia Department of Health Care Finance; the Commissioner of the District of Columbia Department of Insurance, Securities and Banking; the Director of the District of Columbia Department of Health; and the Director of the District of Columbia Department of Human Services.

In addition, a standing Advisory Board consisting of nine members, who are residents of the District of Columbia, works closely with the Executive Board. Pursuant to HBX's enabling legislation, the Executive Board may create additional advisory boards as it considers to be appropriate. The advisory boards provide the Executive Board with recommendations on such matters as: insurance standards, covered benefits, premiums, plan certification, internet technology system development, and other policies or operational issues as required by the Executive Board.

HBX is funded by federal grants through the U.S. Department of Health and Human Services made available with the passage of the Patient Protection and Affordable Care Act, approved on March 23, 2010.

**Financial Highlights**

- The Health Benefit Exchange Authority Establishment Act of 2011 became effective on March 2, 2012. However, HBX began operations on October 1, 2012, the start of fiscal year 2013.
- HBX's total assets exceeded liabilities by \$27,744,210 at September 30, 2013, which is reported as invested in capital assets in the Statement of Net Position.

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

**Management's Discussion and Analysis**

September 30, 2013

Unaudited

- HBX's revenues exceeded expenses by \$27,744,210 for the year ended September 30, 2013, which is the result of the federal grants funding the development of the DC Health Link.

**Overview of the Financial Statements**

Management's discussion and analysis (MD&A) is intended to serve as an introduction to HBX's basic financial statements. HBX's financial report includes three financial statements: the Statement of Net Position; the Statement of Revenues, Expenses and Changes in Net Position; and the Statement of Cash Flows. These financial statements and related note disclosures provide information about the activities of HBX.

1. ***Statement of Net Position*** – The Statement of Net Position presents information on HBX's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position (which is defined as the residual of all other financial statement elements presented in a statement of net position.)
2. ***Statement of Revenues, Expenses, and Changes in Net Position*** – The Statement of Revenues, Expenses, and Changes in Net Position reports operating revenues and expenses and nonoperating revenues and expenses of HBX for the fiscal year. The difference – increase or decrease in net position – is presented as the change in net position for the fiscal year. The cumulative differences from inception forward will be presented as the net position of HBX, reconciling to total net position reflected on the Statement of Net Position.
3. ***Statement of Cash Flows*** - The Statement of Cash Flows presents information showing how HBX's cash and cash equivalents balances changed during the fiscal year. The Statement of Cash Flows classifies cash receipts and cash payments as resulting from operating activities, capital and related financing activities, noncapital financing activities and investing activities. The net result of those activities is reconciled to the cash and cash equivalents balances reported at the end of the fiscal year. This statement is prepared using the direct method, which allows the reader to easily understand the amount of cash received and how much cash was disbursed.
4. ***Notes to the Financial Statements*** – The notes to the financial statements provide additional information that is essential for a complete understanding of the data provided in the basic financial statements.

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

Management's Discussion and Analysis

September 30, 2013

Unaudited

**Financial Analysis of HBX**

Condensed Financial Information:

HBX reported no deferred outflow of resources or deferred inflow of resources at the end of fiscal year 2013. The following table provides a summary of HBX's total assets, liabilities, and net position as of September 30, 2013:

**Table I – Condensed Schedule of Net Position**

	<u>2013</u>
Current assets	\$ 10,914,705
Non-depreciable capital assets	<u>27,744,210</u>
<b>Total assets</b>	<b><u>38,658,915</u></b>
 Current liabilities	 <u>10,914,705</u>
<b>Total liabilities</b>	<b><u>10,914,705</u></b>
 Net position:	
Net investment in capital assets	<u>27,744,210</u>
<b>Total net position</b>	<b><u>\$ 27,744,210</u></b>

Over time, net position can serve as a useful indicator of an organization's financial position. At September 30, 2013, HBX's assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources by \$27,744,210.

Capital assets, comprised solely of Construction in Progress (CIP), represented the largest portion of HBX's total assets. At the end of fiscal year 2013, capital assets represented 71.8% of total assets. The CIP balance of \$27,744,210 is related to the development of DC Health Link, an online marketplace that allows users to shop, compare, and select health insurance. The development and implementation of this system was critical to HBX's ability to fulfill its primary mission of educating consumers about insurance options and assisting them in accessing necessary information.

The most significant portion of liabilities was in Accounts Payable, which represented 58.6% of total liabilities at September 30, 2013. The Accounts Payable balance of \$6,400,773 represents amounts owed to HBX's vendors, suppliers, and consultants. In addition, Due to Primary Government, which represents operating advances from the Primary Government, comprised 39.1% of total liabilities.

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the District of Columbia)

**Management's Discussion and Analysis**

September 30, 2013

Unaudited

HBX's net position totaled \$27,744,210 at September 30, 2013. This balance resulted from excess revenues generated by Federal grants from the U.S. Department of Health and Human Services during the fiscal year. HBX did not generate operating revenues in fiscal year 2013.

The following table presents condensed financial information from the Statement of Revenues, Expenses and Changes in Net Position for the year ended September 30, 2013:

**Table II – Condensed Schedule of Revenues, Expenses, and Changes in Net Position**

	<u>2013</u>
Operating revenues	\$ -
Operating expenses	<u>16,155,046</u>
Operating loss	<u>(16,155,046)</u>
Nonoperating revenue	<u>43,899,256</u>
Change in net position	<u><u>\$ 27,744,210</u></u>

During fiscal year 2013, HBX's revenues and capital contributions totaled \$43,899,256. These revenues were derived from grants provided by the federal government. The total cost of all HBX activities and services was \$16,155,046. Consequently, the increase in net position was \$27,744,210.

**Contacting HBX's Management**

This financial report is designed to provide a general overview of HBX's finances. Additional information regarding HBX's financial statements may be obtained from: Health Benefit Exchange Authority, Executive Director, 1100 15<sup>th</sup> Street, N.W., 8<sup>th</sup> Floor, Washington, D.C. 20005.

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

Statement of Net Position

September 30, 2013

<b>Assets:</b>	<b><u>2013</u></b>
<b>Current assets:</b>	
Due from primary government (Note 3)	\$ 10,914,705
<b>Noncurrent assets:</b>	
Non-depreciable capital assets (Note 4)	<u>27,744,210</u>
Total assets	<u>38,658,915</u>
<b>Liabilities:</b>	
<b>Current liabilities:</b>	
Accounts payable (Note 5)	6,400,773
Due to primary government (Note 5)	4,272,259
Compensation payable	<u>241,673</u>
Total liabilities	<u>10,914,705</u>
<b>Net Position</b>	
Net investment in capital assets	<u>27,744,210</u>
Total net position	<u>\$27,744,210</u>

*The accompanying notes are an integral part of this statement.*



**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

Statement of Revenues, Expenses, and Changes in Net Position

For the Year Ended September 30, 2013

	<u>2013</u>
Operating revenues:	
Total operating revenues	<u>\$ -</u>
Operating expenses:	
Salaries	1,950,578
Supplies and materials	20,424
Contractual and professional support services	59,556
IT and communications	7,667,020
Professional support	4,528,143
Eligibility and enrollment support	317,999
Consumer education and outreach	1,047,295
General and administrative	564,031
Total operating expenses	<u>16,155,046</u>
Operating loss	(16,155,046)
Nonoperating revenue	
Federal grant - operating (Note 6)	16,155,046
Total nonoperating revenues	<u>16,155,046</u>
Change in net position before Federal capital grants	-
Federal grant - capital (Note 6)	<u>27,744,210</u>
Change in net position	27,744,210
Net position - beginning of year	-
Net position - end of year	<u>\$ 27,744,210</u>

*The accompanying notes are an integral part of this statement.*

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

Statement of Cash Flows

For the Year Ended September 30, 2013

	<u>2013</u>
Cash flows from operating activities:	
Payments to employees	\$ (1,708,905)
Payments to suppliers	(7,803,695)
Net cash and cash equivalents used in operating activities	<u>(9,512,600)</u>
Cash flows from noncapital financing activities:	
Proceeds from federal grants -operating	5,240,341
Advances from primary government	4,272,259
Net cash and cash equivalents provided by noncapital financing activities	<u>9,512,600</u>
Cash flows from capital and related financing activities:	
Proceeds from federal grants - capital	27,744,210
Acquisition of capital assets	(27,744,210)
Net cash and cash equivalents used by capital and related financing activities	<u>-</u>
Net increase (decrease) in cash and cash equivalents	-
Cash and cash equivalents, beginning of year	-
Cash and cash equivalents, end of year	<u>\$ -</u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	\$(16,155,046)
Increase in liabilities:	
Accounts payable	6,400,773
Compensation payable	241,673
Net cash and cash equivalents used in operating activities	<u>\$ (9,512,600)</u>

*The accompanying notes are an integral part of this statement.*

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

Notes to Financial Statements

September 30, 2013

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Background**

The District of Columbia Health Benefit Exchange Authority (HBX) was established pursuant to Section 3 of the Health Benefit Exchange Authority Establishment Act of 2011, which became effective on March 3, 2012 (D.C. Law 19-0094.) HBX began operations on October 1, 2012.

HBX's mission is to implement and administer a health care exchange program in the District of Columbia in accordance with the Patient Protection and Affordable Care Act (PPACA), thereby ensuring access to quality and affordable health care to all District residents.

The health care exchange program is designed to provide individuals and small employers with the ability to find affordable and easier-to-understand health insurance and assist small employers in purchasing qualified health benefit plans for their employees. The exchange also serves to facilitate the purchase of qualified health plans and assist individuals and groups in accessing programs, premium assistance tax credits and cost-sharing reductions.

To fulfill its purpose as mandated by law, HBX manages DC Health Link, an on-line marketplace created for individuals, families, small business owners and their employees in the District of Columbia to shop, compare, and select health insurance that meets their health needs and budgets. District residents, small business owners and their employees can use DC Health Link to apply for coverage, determine whether they are eligible for help to lower the cost of their insurance, compare options, and enroll in the plan of their choice. DC Health Link may also be used by low-income residents to apply for Medicaid.

**B. Financial Reporting Entity**

For financial reporting purposes, HBX is reported as a discretely presented component unit of the District of Columbia government. Consistent with the authoritative guidance of the Governmental Accounting Standards Board (GASB), the following criteria are used to determine an entity's financial reporting status:

- The organization is a legally separate entity.
- The District of Columbia appoints a voting majority of the organization's board.
- There is a financial benefit/burden relationship between the District of Columbia and the organization or the District of Columbia is able to impose its will on the organization.

HBX is reported as a discretely presented component unit of the District of Columbia because the District of Columbia is able to approve or modify the HBX's budgets and may overrule, veto, or modify certain decisions made by HBX's governing board (e.g., the awarding of contracts valued at \$1 million or more.) Therefore, the District of Columbia is able to impose its will on the HBX. Also, the Council must approve the rules adopted by HBX, thereby demonstrating the District of Columbia's ability to modify or approve the rates or fees charged by HBX.

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

Notes to Financial Statements

September 30, 2013

**C. Basis of Presentation**

The accompanying financial statements of HBX have been prepared in accordance with U.S. generally accepted accounting principles (GAAP), as prescribed by GASB. HBX has prepared a Statement of Net Position; a Statement of Revenues, Expenses, and Changes in Net Position; and a Statement of Cash Flows, along with the required supplementary information titled, "Management's Discussion and Analysis," which precedes the financial statements.

**D. Measurement Focus and Basis of Accounting**

HBX's transactions and business events are accounted for using a flow of economic resources measurement focus. Under this measurement focus, all assets, deferred outflows of resources, liabilities, and deferred inflows of resources associated with HBX's operations are included on the Statement of Net Position. Net position is further categorized into Net Investment in Capital Assets, Restricted, and Unrestricted.

HBX prepares its financial statements using the accrual basis of accounting. Under this basis of accounting, revenues are recognized when earned and expenses are recognized when a liability is incurred regardless of the timing of the related cash flows. Grants and similar items are recognized when all eligibility requirements imposed by the provider have been met.

**E. Cash and Cash Equivalents**

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and mature in such a short period of time that their values are effectively immune from changes in interest rates. HBX considers all highly liquid investments with an original maturity of 90 days or less when purchased to be cash equivalents. HBX held no cash or cash equivalents during fiscal year 2013.

**F. Investments**

Pursuant to Section 4(d) of the Health Benefit Exchange Authority Establishment Act of 2011, HBX monies are to be invested in the same manner as are other District funds. Accordingly, HBX is authorized by District laws to invest funds in a manner that will preserve principal and meet the entity's anticipated daily cash requirements, while maximizing investment earnings. HBX is authorized to invest in obligations of the United States and agencies thereof, prime commercial paper, bankers' acceptances and repurchase agreements fully collateralized in obligations of the United States government and agency securities.

Investments purchased by HBX must be consistent with the provisions of the Financial Institutions Deposit and Investment Act of 1997 (D.C. law 12-56) and the District of Columbia's Cash and Investment Policy, adopted in November 2008. HBX held no investments during fiscal year 2013.

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

Notes to Financial Statements

September 30, 2013

**G. Capital Assets and Depreciation**

HBX defines capital assets as classes of assets with an initial aggregate cost of more than \$5,000 and estimated useful life in excess of one year. Such assets are to be recorded at historical cost or estimated historical cost if purchased or constructed.

The estimated useful lives for capital assets are as follows:

<u>Asset Class</u>	<u>Useful Life</u>
Internally Developed Software	3 – 5 years
Equipment and Machinery	5 – 10 years
Furniture and Fixtures	5 years
Vehicles (and Other Mobile Equipment)	5 – 12 years
Leasehold Improvements	10 years, not to exceed the term of the lease

Depreciation is to be calculated on each class of depreciable property using the straight-line method. HBX depreciated no assets as of September 30, 2013 because operations did not begin until October 1, 2013.

Non-depreciable capital assets at September 30, 2013 included Construction-in-Progress (CIP) related to the development of the online health insurance marketplace, DC Health Link. At September 30, 2013, the components of CIP were primarily computer equipment, consultant salaries and software.

**H. Operating and Nonoperating Revenues and Expenses**

Revenues and expenses are distinguished between operating and nonoperating items. Operating revenues generally result from providing services in connection with HBX's principal ongoing operations. HBX did not generate any operating revenues during fiscal year 2013. However, HBX anticipates that in future years, operating revenues will be generated through various sources, including: user fees, licensing fees; and other assessments on health carriers selling qualified dental plans or qualified health plans in the District of Columbia.

Operating expenses include all costs associated with assisting individuals and employers in finding affordable and understandable health insurance; facilitating the purchase and sale of qualified health plans; helping employers enroll their employees in qualified health plans; providing a transparent marketplace for health benefit plans; assisting persons in accessing programs, premium assistance tax credits, and cost sharing reductions; and educating consumers.

All revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

It is the policy of HBX to use restricted resources first, followed by unrestricted when expenses are incurred for purposes for which any of these resources are available. Therefore, HBX considers restricted amounts to have been spent when an expenditure is incurred for purposes for which both restricted and unrestricted net position is available.

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

Notes to Financial Statements

September 30, 2013

**I. Compensated Absences**

Employees accumulate unused sick leave, with no maximum limitation. Annual (vacation) leave may be accumulated up to 240 hours, regardless of the employee's length of service.

Accumulated annual leave is recorded as an expense and liability as the benefits accrue to employees. HBX does not record a liability for accumulated sick leave. However, at the time of retirement, unused sick leave can be used to determine employees' years of service. Employees earn sick leave credits that are considered termination payments at the time of retirement.

**J. Postemployment Benefits**

Full-time employees receive pension benefits through the Social Security System and/or the District of Columbia's Retirement Programs.

Consistent with the Federal Insurance Contributions Act (FICA), a 6.20% Social Security tax is withheld from the gross salary/wages of HBX employees, up to but not exceeding the applicable social security wage base, which was \$113,700 in 2013. In addition, HBX pays a 1.45% payroll tax for Medicare with an additional 1.45% being withheld from each employee's salary/wages.

Under the provisions of D.C. Code § 1-627, the District of Columbia sponsors a defined contribution pension plan (Internal Revenue Code Section 401(a) Plan) for permanent full-time employees who are covered under the Social Security System. Eligible HBX employees may participate in this plan. The District of Columbia contributes 5% of base salaries for eligible employees each pay period. Contributions and earnings vest incrementally beginning after two years of service, including a one-year waiting period and vest fully after five years of service including the one-year waiting period. Contributions and earnings are forfeited for the period of service during which the employee does not achieve incremental vesting, if separation occurs before five years of credited service. During the year, the District contributed \$29,542 on behalf of the HBX employees.

HBX employees may also participate in the District of Columbia's deferred compensation plan established under D.C. Code § 47-3601 in accordance with IRC Section 457. Employees were able to defer the lesser of \$17,500 or 100% of includable compensation in calendar year 2013. A special catch-up provision is also available to participants that allows them to make up or catch up for prior years in which they did not contribute the maximum amount to the plan. An additional deferral is available to participants who are at least 50 years old before the end of the calendar year. Contributions are not assets of the District and the District has no further liability to the plan.

**K. Contractual Commitments**

HBX's contractual commitments are primarily associated with the capital project related to the development of the online health insurance marketplace, DC Health Link. Outstanding contractual commitments related to the capital project as of September 30, 2013 were \$11,035,168. Outstanding contractual commitments are not recorded in the financial statements until goods and services have been received by HBX in accordance with the terms of the related contracts.

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

Notes to Financial Statements

September 30, 2013

**L. Accounting Standards Implemented**

During fiscal year 2013, HBX implemented the following accounting standards issued by the Governmental Accounting Standards Board (GASB):

Statement	Effective Date	Purpose/Impact of Statement
Statement No. 65, <i>Items Previously Reported as Assets and Liabilities</i> , issued March 2012	For periods beginning after December 15, 2012 (earlier application encouraged)	Establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.
Statement No. 63, <i>Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position</i> , issued June 2011	For periods beginning after December 15, 2011 (earlier application encouraged)	Provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Amends the net asset reporting requirements in Statement No. 34, <i>Basic Financial Statements— and Management's Discussion and Analysis— for State and Local Governments</i> , and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure net position, rather than net assets.
Statement no. 62, <i>Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements</i> , issued December 2010	For periods beginning after December 15, 2011 (earlier application encouraged)	Incorporates into the GASB's authoritative literature certain accounting and financial guidance included in (a) FASB Statements and Interpretations; (b) APB Opinions; and (c) Accounting Research Bulletins of the AICPA Committee on Accounting Procedure which does not conflict with or contradict GASB pronouncements. Supersedes Statement No. 20, <i>Accounting and Financial Reporting for Proprietary Fund Accounting</i> .
Statement No. 61, <i>The Financial Reporting Entity: Omnibus – an Amendment of GASB Statements No. 14 and No. 34</i> , issued November 2010	For periods beginning after June 15, 2012 (earlier application encouraged)	Modifies certain requirements for inclusion of component units in the financial reporting entity. Also amends, in certain circumstances, the criteria for reporting component units as if they were part of the primary government and clarifies the reporting of equity interest in a component unit as an asset.
Statement No. 60, <i>Accounting and Financial Reporting for Service Concession Arrangements</i> , issued November 2010	For periods beginning after December 15, 2011	Establishes recognition, measurement, and disclosure requirements for service concession arrangements (SCAs) for both transferors and governmental operators, requiring governments to account for and report SCAs in the same manner, which improves the comparability of financial statements.

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

Notes to Financial Statements

September 30, 2013

**M. Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**2. CASH**

The District of Columbia follows the practice of pooling cash and cash equivalents for some of its governmental funds and component units in order to provide better physical custody and control of cash, to enhance operational efficiency, and to maximize investment opportunities. HBX was included in the pooling of cash during fiscal year 2013. Therefore, there were no cash accounts that were under the direct control of HBX during the year. As further discussed in Note 5, HBX overspent its portion of pooled cash in fiscal year 2013 which resulted in a liability being owed to the District of Columbia.

**3. DUE FROM THE PRIMARY GOVERNMENT**

Pursuant to the Patient Protection and Affordable Care Act, the District Department of Health Care Finance was awarded grants by the federal government to support the establishment of a health care exchange program to serve District residents and employers. In July 2012, the Department of Health Care Finance was awarded a grant in the amount of \$8,200,716, which expired on August 13, 2013. In addition, in June 2013, the Department of Health Care Finance was awarded a grant in the amount of \$89,954,422, which will expire on September 26, 2014. As expenditures were incurred by HBX in developing the legally mandated exchange, the Department of Health Care Finance reimbursed the agency from the federal grant funds received for that purpose. During the year ended September 30, 2013, the HBX incurred \$27,744,210 of costs associated with the development of the HBX which were funded from proceeds of the Federal grant. During the year ended September 30, 2013, the HBX incurred \$16,155,046 for salaries, IT and communications, professional support, and other operating expenses. \$10,914,705 had not been reimbursed by the District of Columbia. This amount is presented as Due from the Primary Government in HBX's financial statements.



**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

Notes to Financial Statements

September 30, 2013

**4. CAPITAL ASSETS**

A summary of HBX's capital assets for the year ended September 30, 2013 follows:

	<u>September 30,</u> <u>2013</u>
Capital assets, not being depreciated:	
Construction in Progress	\$ 27,744,210
Total capital assets, not being depreciated	<u>27,744,210</u>
 Total capital assets, being depreciated, net	 <u>-</u>
 Total capital assets	 <u><u>\$ 27,744,210</u></u>

**5. LIABILITIES**

**Accounts Payable**

Accounts payable totaled \$6,400,773 at September 30, 2013. This balance represents amounts owed to HBX's vendors, suppliers, and consultants.

**Due to Primary Government**

As discussed in Note 2, HBX participates in the District of Columbia's pooling of cash. As of September 30, 2013, the District of Columbia had advanced \$4,272,259 to the HBX, which is presented as Due to Primary Government in HBX's financial statements.

**6. FEDERAL CONTRIBUTION**

Section 1311 of the Patient Protection and Affordable Care Act makes grant funds available to all state-based exchanges, including HBX, to assist them in planning, establishing, and operating their own state-based marketplaces. Consistent with this Act, such grant funds must be spent before January 1, 2015. In addition, the Act requires that state-based marketplaces be financially self-sustaining by January 1, 2015.

During fiscal year 2013, the District on behalf of HBX received federal grant funds totaling \$43,899,256 in support of its planning and organizational activities with \$27,744,210 being used to fund capital costs associated with the development of the DC Health Link.

**DISTRICT OF COLUMBIA HEALTH BENEFIT EXCHANGE AUTHORITY**  
(A Component Unit of the Government of the District of Columbia)

**Notes to Financial Statements**

**September 30, 2013**

**7. RISK MANAGEMENT**

HBX is exposed to various risks of loss related to: torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During fiscal year 2013, HBX was covered under the District of Columbia's self-insured risk management plan. Accordingly, any claim settlements and/or judgments pertaining to HBX would have been paid from the District of Columbia's general fund resources. For future years, HBX will continue to be covered under the District's self-insured risk management plan. HBX had no claims during fiscal year 2013.



KPMG LLP  
Suite 12000  
1801 K Street, NW  
Washington, DC 20006

**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***

Executive Director and Board of Directors of the  
District of Columbia Health Benefit Exchange Authority  
Inspector General of the Government of the District of Columbia

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 District of Columbia Health Benefit Exchange Authority (the Authority), a component unit of the Government of the District of Columbia, which comprise the statement of financial position as of September 30, 2013, 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 February 18, 2014.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Authority'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 the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying schedule of findings and responses, we identified a deficiency in internal control that we consider to be a material weakness.

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. We consider the deficiency described in the accompanying schedule of findings and responses to be a material weakness.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Authority'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*.



### **The Authority's Response to Findings**

The Authority's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The Authority'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 the Authority's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

**KPMG LLP**

February 18, 2014

## Schedule of Findings and Responses

### Controls Over the Financial Reporting Process Need Improvement

#### *Background:*

The Authority began its operations effective October 1, 2012. During fiscal year 2013, the Authority's accounting transactions were processed by the District and captured in the District's general ledger, System of Accounting and Record (SOAR), using the modified accrual basis of accounting. The Authority's financial statements are required to be prepared in accordance with the accrual basis of accounting. Under the modified accrual basis of accounting, all costs incurred during the fiscal year are reported as expenditures in the operating statement. Under the accrual basis of accounting, costs incurred related to capital assets that have a useful life greater than a year, such as costs to develop the Authority's new DC Health Link system, are reported as capital assets (software development in progress) on the statement of net position (balance sheet). At fiscal year end, the District Office of Financial Operations and Systems (OFOS) assisted the Authority in compiling its financial statements based on activity reflected in SOAR for the year ended September 30, 2013. In addition, during FY 2013, the District and the Authority worked together on the development and implementation of a consolidated health insurance and human services eligibility, enrollment, and case management system called the DC Access System (DCAS). This project, which is primarily funded through Federal grants from the U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services, requires the Authority and the District to closely monitor project costs to ensure that all costs allocable to the Authority are being captured in the Authority's accounts within SOAR.

#### *Condition:*

During the FY 2013 financial statement audit, we noted that the Authority did not have a control to ensure that all costs incurred that meet the criteria to be capitalized in accordance with the accrual basis of accounting are being capitalized. As a result, we identified capital costs in the amount of \$2,075,229 that were erroneously included in operating expenses in the Authority's financial statements. This error was not detected by the Authority's internal controls. Management subsequently corrected this error in the financial statements.

#### *Criteria:*

The *Government Auditing Standards or Yellow Book, Appendix I, section A1.08 d.* states that management at a State and Local government entity is responsible for "establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met; following laws and regulations; and ensuring that management and financial information is reliable and properly reported."

#### *Cause:*

Authority management did not perform a review of all expenditures incurred during FY 2013 to ensure that all costs meeting the criteria to be capitalized under the accrual basis of accounting are being identified and capitalized in the Authority's financial statements. This is necessary because the District is accounting for transactions using the modified accrual basis of accounting under which all costs are expended when incurred. As such, reviewing transactions to identify whether or not they are capitalizable under the accrual basis of accounting is not being performed by the District.

#### *Effect:*

Construction in progress was understated and operating costs were overstated by \$2,075,299 in the Authority's financial statements as of and for the year ended September 30, 2013.

*Recommendations:*

We recommend that the Authority:

1. Develop and implement a process for reviewing all expenditures incurred throughout the year as reported in SOAR to ensure they are properly expensed or capitalized in the Authority's financial statements at fiscal yearend;
2. Maintain a general ledger of the Authority's accounts on a full accrual basis of accounting on a monthly basis. This will facilitate the preparation of periodic financial statements for distribution to Authority management and the Board of Directors. As part of this process the Authority should also prepare monthly reconciliations between the Authority's accrual basis general ledger and related financial statements and the activity being captured by the District for the Authority in SOAR; and
3. Develop a capital asset subsidiary ledger to capture detailed information associated with its capital assets as this information is not currently being maintained by the District.

*The Authority's Response:*

Management concurs with the finding and recommendations with an explanation.

There is a process in SOAR for recording expenditures which need to be expensed or capitalized. Expenditures to be capitalized are recorded in a separate fund from expenditures to be expensed. The expenditure in question was improperly classified from the Capital Fund (Fund 0350) to the Operating Fund (Fund 8200). Expenditures are identified and reviewed yearlong to determine its proper classification. As an additional level of the review the Accounting Officer and the Agency Fiscal Officer of the Health Benefits Exchange Authority will review all expenditures prior to them being reported on the financial statements.

The Authority would explore the auditor's recommendation to procure an independent accounting system outside of SOAR that will facilitate the preparation of period financial statements; prepare monthly reconciliations; and prepare the Authority's accounts on a full accrual basis of accounting.