

**REPORT OF THE AUDIT OF THE
KENTUCKY HEALTH BENEFIT EXCHANGE**

**For The Fiscal Year Ended
June 30, 2014**



**ADAM H. EDELEN
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ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

Audrey Tayse Haynes, Secretary
Cabinet for Health and Family Services
Carrie Banahan, Executive Director
Kentucky Office of Health Benefit and Health Information Exchange

Independent Auditor's Report

Report on the Financial Statements

We have audited the accompanying financial statements of the Kentucky Health Benefit Exchange (KHBE) as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively the KHBE'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 accounting principles generally accepted in the United States of America; 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's 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



Audrey Tayse Haynes, Secretary
Cabinet for Health and Family Services
Carrie Banahan, Executive Director
Kentucky Office of Health Benefit and Health Information Exchange
(Continued)

Auditor's Responsibility (Continued)

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 respective financial position of the KHBE as of June 30, 2014, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages seven through nine 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 Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the KHBE's basic financial statements. The schedule of expenditures of federal awards, as required by Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations is presented for purposes of additional analysis and are not a required part of the basic financial statements.

Audrey Tayse Haynes, Secretary
Cabinet for Health and Family Services
Carrie Banahan, Executive Director
Kentucky Office of Health Benefit and Health Information Exchange
(Continued)

Other Matters (Continued)

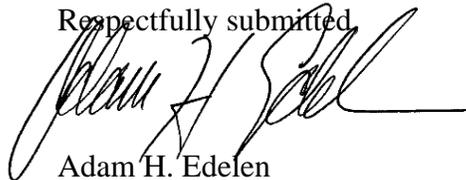
Other Information (Continued)

The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 13, 2015, on our consideration of KHBE'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 KHBE's internal control over financial reporting and compliance.

Respectfully submitted,



Adam H. Edelen
Auditor of Public Accounts

March 13, 2015

MANAGEMENT'S DISCUSSION AND ANALYSIS

KENTUCKY HEALTH BENEFIT EXCHANGE MANAGEMENT'S DISCUSSION AND ANALYSIS

The following narrative and analysis is provided as an overview of the financial activities of the Kentucky Health Benefit Exchange (KHBE) for the fiscal year ended June 30, 2014, to assist the reader in an assessment of the financial condition of the KHBE. Please assess this narrative and analysis in conjunction with the KHBE's financial statements and the accompanying notes.

OVERVIEW

Section 1311(b) of the Affordable Care Act (Patient Protection and Affordable Care Act, P.L. 111-148, as amended by the Health Care and Education Reconciliation ACT P.L. 111-152, hereafter referred to as "ACA") requires the establishment of an American Health Benefit Exchange in each state and establishes the requirements of a health benefit exchange. The Kentucky Health Benefit Exchange (KHBE) was first authorized by Executive Order on July 17, 2012 as a state agency within the Commonwealth of Kentucky's Cabinet for Health and Family Services. The KHBE facilitates the purchase and sale of health plans in the individual market; assists small employers in facilitating the enrollment of their employees in health plans; provides one-stop shopping by also helping individuals enroll in Medicaid and Kentucky Children's Health Insurance Program (KCHIP) health plans; enables individuals to receive premium tax credits, premium subsidies, and reduced cost sharing; and qualifies small business for tax credits. Kentucky's health benefit exchange is trademarked as *kynect* and referred to as *kynect* or KHBE. Open enrollment in the KHBE began on October 1, 2013, for coverage effective January 1, 2014. Subsequent Executive Orders issued on June 19, 2013 and June 30, 2014 continued the establishment and operation of the KHBE.

Under the "No Wrong Door" approach established by the ACA to use a single eligibility determination and enrollment process so consumers would not have to navigate multiple agencies and systems, Kentucky's exchange was designed to accept applications and determine eligibility for both Qualified Health Plans (QHP) and Medicaid applicants. As a result, a cost allocation plan (CAP) was developed to meet federal requirements that shared costs be allocated appropriately among the programs utilizing the same services. Therefore, costs associated with all three programs are allocated among the KHBE, Medicaid and KCHIP based on the federally approved CAP while costs strictly associated with one program are not cost allocated with others.

FUNDING

KHBE's initial funding, to establish *kynect* and fund operation through June 30, 2014, is provided through federal grants awarded by the U. S. Department of Health and Human Services:

- Exchange Planning Grant, \$1,000,000, awarded September 30, 2010
- First Level 1 Establishment Grant, \$7,670,803, awarded August 15, 2011
- Second Level 1 Establishment Grant, \$57,896,810, awarded February 22, 2012
- Third Level 1 Establishment Grant, \$4,423,000, awarded September 27, 2012
- Level 2 Establishment Grant, \$182,707,738, awarded January 16, 2013

The ACA requires each State to ensure that its exchange has sufficient funding in order to support its ongoing operations beginning January 1, 2015. The KHBE's self-sustainability will be achieved through a broad-based premium assessment on all issuers offering health benefit plans and stop loss policies. The KHBE will not receive any state general fund appropriations.

**KENTUCKY HEALTH BENEFIT EXCHANGE
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

FUNDING (CONTINUED)

The Commonwealth of Kentucky's biennium budget for state fiscal years (SFY) 15 and 16 was approved by the General Assembly in the spring of 2014. Approved within the biennium budget of KHBE is revenue derived from a 1% broad based premium assessment. At the time of the budget submission in the fall of 2013, the revenue that could be generated from a 1% broad based assessment was forecasted by the Office of State Budget Director (OSBD) at \$24.8M in SFY 15 and \$28M in SFY 16.

FINANCIAL STATEMENTS

KHBE financial statements include the Statement of Net Position; the Statement of Revenues, Expenses, and Changes in Net Position; and the Statement of Cash Flows. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Standards Accounting Board (GASB). These financial statements and related note disclosures are designed to provide an overview of KBHE's financial position and activities.

Statement of Net Position – The Statement of Net Position presents information on KBHE's assets, liabilities, and net position. Over time, net position can serve as a useful indicator whether the financial position of KBHE is improving or deteriorating. As of June 30, 2014, the statement reflects assets in the amount of \$43,805,763 with capital assets representing approximately 56% of the total assets due to the development of kynect. The most significant portion of liabilities was accounts payables, \$19,964,752, which represented 95% of total liabilities. These accounts payable balance represents amounts owed to vendors, suppliers and consultants; approximately 54% of this balance relates to contract holdbacks. The following table provides a summary of KBHE's net position as of June 30, 2014:

**Condensed Statement of Net Position
As of June 30**

Current Assets	\$ 20,534,703
Capital Assets	<u>23,271,060</u>
Total Assets	<u>43,805,763</u>
Current Liabilities	21,075,399
Noncurrent Liabilities	<u>253,532</u>
Total Liabilities	<u>21,328,931</u>
Net investment in Capital Assets	21,736,674
Restricted	<u>740,158</u>
Total Net Position	<u>\$ 22,476,832</u>

**KENTUCKY HEALTH BENEFIT EXCHANGE
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

FINANCIAL STATEMENTS (CONTINUED)

Statement of Revenues, Expenses, and Changes in Net Position – The Statement of Revenues, Expenses and Changes in Net Position reports operating revenues and expenses for KHBE as of June 30, 2014. The difference (increase or decrease) is presented as the change in net position. Operating revenue totaled \$97,978,190 and operating expenses was \$93,995,903 resulting in a net position increase of \$3,982,287 for state fiscal year ending 2014. The following table provides a summary of KBHE's revenue, expenses, and change in net position as of June 30, 2014:

**Condensed Statement of Revenues, Expenses,
and Changes in Net Position
For the Fiscal Year Ended June 30**

Total Operating Revenues	\$ 97,978,190
Total Operating Expenses	93,995,903
Change in Net Position	3,982,287
Net Position at July 1, 2013	18,494,545
Net Position at June 30, 2014	\$ 22,476,832

Statement of Cash Flows – The Statement of Cash Flows presents information showing relative to how KHBE's cash and cash equivalents balances changed during the period. The Statement of Cash Flows classifies cash receipts and cash payments as resulting from operating activities, capital and related financing activities, noncapital activities and investing activities. The net result of those activities is reconciled to the cash balance reported at the end of the period. 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.

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 financial statements. A comparative analysis will be provided in future years when prior-year information is available for such purpose.

CONTACTING KHBE'S MANAGEMENT

KHBE's financial statements are designed to provide a general overview of KHBE's finances. Additional information regarding KHBE's financial statements may be obtained from: Office of Kentucky Health Benefit and Health Information Exchange, 8 Mill Creek Park, Frankfort, KY 40601.

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FINANCIAL STATEMENTS

KENTUCKY HEALTH BENEFIT EXCHANGE
STATEMENT OF NET POSITION
June 30, 2014

Assets

Current Assets:

Federal grant receivable, net (Note 1)	\$ 20,102,957
Intergovernmental receivable (Note 1)	431,746
Total Current Assets	<u>20,534,703</u>

Non-current Assets:

Capital Assets (Note 4)	
Machinery and equipment	190,028
Software	24,355,664
Less: Accumulated depreciation and amortization	<u>(1,274,632)</u>
Total Non-current Assets	<u>23,271,060</u>

Total Assets	<u>43,805,763</u>
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Liabilities

Current Liabilities:

Accounts payable	19,964,752
Intergovernmental payable (Note 3)	979,389
Capital leases (Note 5)	19,670
Compensated absences (Note 9)	111,588
Total Current Liabilities	<u>21,075,399</u>

Non-current Liabilities

Compensated absences (Note 9)	202,420
Capital leases (Note 5)	51,112
Total Non-current Liabilities	<u>253,532</u>

Total Liabilities	<u>21,328,931</u>
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Net Position

Net investment in capital assets	21,736,674
Restricted	740,158
	<u>740,158</u>

Total Net Position	<u>\$ 22,476,832</u>
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The accompanying notes are an integral part of the financial statements.

**KENTUCKY HEALTH BENEFIT EXCHANGE
STATEMENT OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION
For The Year Ended June 30, 2014**

Operating Revenues:	
Federal grants	\$ 96,504,826
SHOP premiums	888,990
Agency cost reimbursement for Medicaid Program	584,374
Total Operating Revenues	<u>97,978,190</u>
Operating Expenses:	
Personnel and contracted services	85,713,035
Utilities, rental, and other services	3,193,399
Commodities and supplies	1,752,623
Depreciation and amortization	1,248,298
Grants and subsidies	1,238,127
SHOP payments	775,029
Travel	68,013
Interest expense	7,379
Total Operating Expenses	<u>93,995,903</u>
Change in net position	3,982,287
Net Position at July 1, 2013	<u>18,494,545</u>
Net Position at June 30, 2014	<u>\$ 22,476,832</u>

The accompanying notes are an integral part of the financial statements.

KENTUCKY HEALTH BENEFIT EXCHANGE
STATEMENT OF CASH FLOWS
For The Year Ended June 30, 2014

Cash flows from operating activities:	
Cash received from SHOP	\$ 888,990
Cash received from federal grants	83,265,876
Cash received from Medicaid reimbursements	584,374
Cash payments for personnel and contracted services	(68,101,997)
Cash payments for goods and services	(10,019,360)
Cash payments to other sources	<u>(1,245,506)</u>
Net cash provided (used) by operating activities:	<u>5,372,377</u>
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(5,354,421)
Principal paid on revenue bond maturities and equipment contracts	<u>(17,956)</u>
Net cash provided (used) for capital and related financing activities:	<u>(5,372,377)</u>
Net change in cash and cash equivalents	0
Cash and cash equivalents at July 1, 2013	<u>0</u>
Cash and cash equivalents at June 30, 2014	<u>\$ 0</u>
Reconciliation of income from operations to net cash flows from operating activities:	
Operating income (loss)	\$ 3,982,287
Adjustments to reconcile operating income to net cash provided (used) by operating activities:	
Depreciation and amortization	1,248,298
Increase (decrease) in assets:	
Federal grants receivable, net	(12,843,224)
Intergovernmental receivable, net	(395,724)
Increase (decrease) in liabilities:	
Accounts payable	17,601,977
Intergovernmental payable	(4,298,310)
Compensated absences	<u>77,073</u>
Net cash provided (used) by operating activities:	<u>\$ 5,372,377</u>

The accompanying notes are an integral part of the financial statements.

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NOTES TO THE FINANCIAL STATEMENTS

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Kentucky Health Benefit Exchange (KHBE) is presented to assist in understanding the KHBE's financial statements. The financial statements and notes are representations of the KHBE's management, which is responsible for their integrity and objectivity. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the financial statements.

Nature of Activities

Section 1311(b) of the Affordable Care Act (Patient Protection and Affordable Care Act, P.L. 111-148, as amended by the Health Care and Education Reconciliation ACT P.L. 111-152, hereafter referred to as "ACA") requires the establishment of an American Health Benefit Exchange in each state and establishes the requirements of a health benefit exchange. The Kentucky Health Benefit Exchange (KHBE) was first authorized by Executive Order on July 17, 2012 as a state agency within the Commonwealth of Kentucky's Cabinet for Health and Family Services. The KHBE facilitates the purchase and sale of health plans in the individual market; assists small employers in facilitating the enrollment of their employees in health plans; provides one-stop shopping by also helping individuals enroll in Medicaid and Kentucky Children's Health Insurance Program (KCHIP) health plans; enables individuals to receive premium tax credits, premium subsidies, and reduced cost sharing; and qualifies small business for tax credits. Open enrollment in the KHBE began on October 1, 2013, for coverage effective January 1, 2014. Subsequent Executive Orders issued on June 19, 2013 and June 30, 2014 continued the establishment and operation of the KHBE.

Federal grant funding will finance the Kentucky Health Benefit Exchange design, development, and implementation phases, as well as the first full year of operations during calendar year 2014. Beginning on January 1, 2015, the KHBE, trademarked as kynect, must be financially self-sustaining which will be achieved through a broad-based premium assessment on all issuers offering health benefit plans and stop loss policies. The KHBE will not receive any state general fund appropriations.

Under the "No Wrong Door" approach established by the ACA to use a single eligibility determination and enrollment process so consumers would not have to navigate multiple agencies and systems, Kentucky's exchange was designed to accept applications and determine eligibility for both Qualified Health Plans (QHP) and Medicaid applicants. As a result, a cost allocation plan (CAP) was developed to meet federal requirements that shared costs be allocated appropriately among the programs utilizing the same services. Therefore, costs associated with all three programs are allocated among the KHBE, Medicaid and KCHIP based on the federally approved CAP while costs strictly associated with one program are not cost allocated with others.

Reporting Entity and Basis of Presentation

The accompanying financial statements have been prepared in conformity with the U.S. generally accepted accounting principles (GAAP) and are presented on the economic resources measurement focus and the accrual basis of accounting. Accordingly, revenues are recorded when earned and expenses are recorded when liability is incurred. The KHBE has adopted the pronouncements of the

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014
(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Governmental Accounting Standards Board (GASB), which is the accepted standard governing body for establishing governmental accounting financial reporting principles nationally. The KHBE has no relationship with other entities that could be considered component units.

Cash and Cash Equivalents

The KHBE considers all highly liquid investment securities purchased with an original maturity of three months or less to be cash equivalents.

Grants

Grant Revenue is recognized and recorded as related expenses are incurred. Costs reimbursed by United States government agencies are subject to review and audit by such agencies.

Grants and Medicaid Program Cost Reimbursement Receivable

Federal grants receivable represents unreimbursed federal grant funds as of June 30, 2014, for the Level 1 and Level 2 Establishment Grant and Medicaid grants. Medicaid program cost reimbursement receivable represents unreimbursed agency funds as of June 30, 2014 for the Kentucky Medicaid cost reimbursement. Management believes these amounts are properly reimbursable and fully collectible as of period-end; as such no allowance has been established.

Capital Assets

Purchased capital assets are reported at cost. During 2014, hardware and software assets were purchased by the KHBE under contract with Deloitte Consulting using Level 1 and Level 2 Establishment Grant funds and Medicaid funds.

The policy of the KHBE is to capitalize assets when the useful life is greater than one year and the acquisition cost meets the capitalization threshold. The KHBE's capitalization threshold is \$5,000 for tangible personal property and improvements to land. Intangible capital assets are capitalized when the cost is \$100,000 or more except software, which has a threshold of \$500,000. There were no acquisitions of land or other real property for period ended June 30, 2014.

Cost of assets sold or retired (and related amounts of accumulated depreciation) are eliminated from the accounts in the period of sale or retirement, and the resulting gain or loss is included in operations. Other costs incurred for repairs and maintenance are expensed as incurred.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014
(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Assets are depreciated on the straight-line basis over the estimated useful lives.

Land improvements	10 to 60 years
Buildings	10 to 75 years
Machinery and equipment	3 to 25 years
Infrastructure	20 to 40 years
Intangibles	2 to 40 years

Contracts Holdback Liability

All KHBE contracts contain (30) day cancellation clauses that can be exercised for the convenience of the Commonwealth. There are two (2) contracts that provide significant service value to the KHBE and are identified for holdback liability. These holdback liabilities represent the total amounts and include expenses that will be cost allocated to Medicaid and KCHIP.

The first service contract, effective December 4 2012 was executed for the purpose of purchasing systems integrator services to develop and implement a Health Benefit Exchange System. Under the contract, the Commonwealth is required to retain a holdback of 12.5 % of the purchase price for each deliverable. Fifty percent (50%) of the total retained amount is paid upon approval of System Test Results Deliverable for Release 4 and the remaining amount is paid at the end of the Operational Support and Warranty period described in the contract. The delivery date of the KHBE system is expected to occur during fiscal year 2015; the balance of contract holdback (\$9,223,801) as of June 30, 2014, is reflected as a short term liability with an accompanying receivable of \$9,094,632 due from the federal government and \$129,169 due from other state agencies.

The second service contract, effective May 3, 2013 was executed for the purpose of designing, developing and implementing a Health Benefit Exchange Contact Center. Under this contract, the Commonwealth is required to retain a holdback of 15% of the design, development and implementation costs. These costs are to be paid at the conclusion of the warranty period for the phase 1 milestone. The balance of the contract holdback (\$1,500,549) is reflected as a short term liability with an accompanying receivable of \$1,500,549 due from the federal government.

Statement of Net Position

Net position presents the reporting entity's non-fiduciary assets and liabilities with the difference between the two shown as net position. Net position is reported in three categories:

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014
(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Net investment in capital assets consist of capital assets, net of accumulated depreciation and further reduced by debt net of cash balances, for debt related to the acquisition, construction, or improvement of those assets.

Restricted net position result from constraints placed on net position by creditors, grantors, contributors, and other external parties including those constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted net position are those net position that do not meet the definition of restricted net position or invested in capital assets.

When restricted assets and unrestricted assets are both available for a particular purpose, the KHBE's objective is to use any restricted funds first, since unrestricted funds are available for any purpose and provide for greater financial flexibility.

Operating/Non-Operating Revenue and Expense

The KHBE distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses include all items directly and indirectly related to establishing and running a health insurance marketplace pursuant to the ACA.

Risk Management

The KHBE is exposed to various risks of loss related to torts: theft, damage, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The KHBE utilizes the Commonwealth's Risk Management Fund to mitigate risk exposure.

Use of Estimates

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

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014
(Continued)

NOTE 2 - CASH, CASH EQUIVALENTS, AND INVESTMENTS

The Commonwealth of Kentucky follows the practice of pooling cash, cash equivalents and investments 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. The KHBE was included in the pooling of cash during fiscal year 2014. As further discussed in Note 3, the KHBE over spent its portion of the pool in fiscal year 2014 which resulted in a liability being owed to the pool.

NOTE 3 - INTERGOVERNMENTAL PAYABLES

The KHBE had intergovernmental payables of \$979,389. As discussed in Note 2, the KHBE participates in the Commonwealth of Kentucky's pooling of cash. As of June 30, 2014, the pool had advanced \$865,302 to the KHBE, which is presented as an intergovernmental payable on the financial statements. In addition to the amount due to the pool the KHBE also had intergovernmental payables of \$114,087 due to other state agencies.

NOTE 4 - CAPITAL ASSETS

Capital assets consist of the following at June 30, 2014:

	Balance June 30, 2013	Increases	Decreases	Balance June 30, 2014
Assets:				
Construction in Progress	\$ 19,001,243	\$ 5,354,421	\$ (24,355,664)	\$
Equipment and Machinery	190,028			190,028
Software		24,355,664		24,355,664
Total Assets	<u>19,191,271</u>	<u>29,710,085</u>	<u>(24,355,664)</u>	<u>24,545,692</u>
Depreciation:				
Equipment	(26,334)	(30,514)		(56,848)
Software		(1,217,784)		(1,217,784)
Total Depreciation	<u>(26,334)</u>	<u>(1,248,298)</u>		<u>(1,274,632)</u>
Total Capital Assets, net	<u>\$ 19,164,937</u>	<u>\$ 28,461,787</u>	<u>\$ (24,355,664)</u>	<u>\$ 23,271,060</u>

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014
(Continued)

NOTE 5 - CAPITAL LEASES

At June 30, 2014, capitalized leases included equipment as follows:

Equipment acquired through capital leases are recorded at the lesser of fair market value or present value of future minimum lease payments.

Equipment	\$ 101,351
Total	101,351
Less: Accumulated depreciation	(36,692)
Total Net of Depreciation	<u>\$ 64,659</u>

Future minimum rental commitments for capitalizable leases as of June 30, 2014, are as follows:

Future minimum rental commitments for capitalizable leases as of June 30, 2014, are as follows:

2015	\$ 25,335
2016	25,335
2017	25,335
2018	<u>6,050</u>
Total minimum lease payments	82,055
Less: Amount representing interest of 9.15%	<u>(11,273)</u>
Present value of future minimum lease payments	<u>\$ 70,782</u>

The Kentucky Health Benefit Exchange has entered into various leases for equipment. Generally, leases contain termination clauses providing for cancellation after a 30, 60, or 90 days written notice. In addition, certain leases contain appropriation clauses indicating that continuation of the lease is subject to funding by the General Assembly. It is expected that in the normal course of business most of these leases will be replaced by similar leases.

NOTE 6 - ONLINE MARKETPLACE DEVELOPMENT

During 2013 and 2014, the KHBE incurred \$19,001,243 and \$5,354,421 respectively in costs related to the development of the health benefit exchange online marketplace (kynect) that are being capitalized. The online marketplace has been placed into service; therefore amortization expense was recorded for the period ended June 30, 2014.

**KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014
(Continued)**

NOTE 7 - MEDICAID PROGRAM COST REIMBURSEMENT

On August 10, 2011, the federal government announced a time-limited, specific exception to the cost allocation requirements set forth in OMB Circular A-87 (Section C.3) that requires benefiting programs to pay their share of the cost associated with building state based information technology systems. This allowed the KHBE to allocate a portion of qualifying expenditures to Medicaid and KCHIP at a pre-agreed upon rate. Subsequently, the KHBE worked to discuss, review, and determine the cost allocation methodology for any Medicaid/KCHIP eligible expenditures. On March 20, 2012, the Centers for Medicare and Medicaid Services (CMS) approved the Kentucky Health Benefit Exchange Implementation Advance Planning Document (I-APD) for the design, development, and implementation activities of the state's Health Insurance Exchange that provides a benefit to the state's Medicaid program and KCHIP programs.

NOTE 8 - COMMITMENTS

During fiscal year 2014, the Commonwealth entered into numerous multi-year contract agreements relating to the development of an Exchange. Any agreements that exceed the KHBE's current grant period are contingent upon future grant approval and the broad-based premium assessment levels.

Office Lease

The KHBE has entered into an agreement to lease office space in Frankfort, Kentucky with the commencement date for each state fiscal year July 1 through June 30. All leases contain termination clauses for cancellation after 30, 60, or 90 days written notice to the lessors. It is expected that in the normal course of business, a similar lease will replace this lease. KHBE expenditures for rent under leases for the fiscal year ended June 30, 2014, was \$263,731.

Vendor Contracts

The KHBE has engaged in long-term contracts obligating it to material expenditures in future periods. Remaining obligations under contracts that provide significant service value and could not be easily cancelled within thirty days of notice total approximately \$67.4 million as of June 30, 2014. These long term obligations represent the total amounts and include expenses that will be cost allocated to Medicaid and KCHIP.

The KHBE has received federal financial assistance for specific purposes that are generally subject to review or audit by the grantor agencies. Entitlement to this assistance is generally conditional upon compliance with terms and conditions of grant agreements and applicable federal regulations, including the expenditure of assistance for allowable purposes. Any disallowance resulting from a review or audit may become a liability of the KHBE.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014
(Continued)

NOTE 9 - COMPENSATED ABSENCES

The policy of the Commonwealth of Kentucky is to record the cost of annual and compensatory leave. Annual leave is accumulated at amounts ranging from 7.5 to 16 hours per month, determined by the length of service, with maximum accumulations ranging from 30 to 60 days. The estimated liability and change in the estimated liability for compensated absences for the Health Benefit Exchange as of June 30, 2014, are:

	Beginning				Due Within
	<u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>One Year</u>
Annual Leave	\$ 144,815	\$ 87,750	\$ 46,500	\$ 186,065	\$ 37,203
Compensatory Leave	92,118	213,520	177,695	127,943	74,385
Total	<u>\$236,933</u>	<u>\$301,270</u>	<u>\$224,195</u>	<u>\$ 314,008</u>	<u>\$ 111,588</u>

It is the policy of the Commonwealth to record the cost of sick leave when paid. Generally, sick leave is paid only when an employee is absent due to illness, injury, or related family death. Sick leave accumulated in excess of six months is added to an employee's years of service at the time of retirement. There is no liability recorded for sick leave at June 30, 2014. The estimated accumulated unused sick leave for the Health Benefit Exchange employees at June 30, 2014, was \$283,595.

NOTE 10 - EMPLOYEE PENSION PLANS

All full time employees of the Health Benefit Exchange who work more than one hundred hours per month participate in a multiple-employer cost sharing defined benefit pension plan, the Kentucky Employees Retirement System (KERS), administered by the Board of Trustees of Kentucky Retirement Systems. Cost-of-living adjustments are provided at the discretion of the State Legislature.

Employees hired before September 1, 2008, who retire at or after age 65 with 48 months of credited service are entitled to a retirement benefit based on a range of 1.97% to 2.20% of the final-average salary multiplied by their years of service. Final-average salary is the employee's average of the five fiscal years during which the employee had the highest monthly salary. Benefits fully vest on reaching five years of service. Vested employees may retire after twenty-seven of service and receive full benefits or retire after age 55 or after 25 years of service and receive reduced retirement benefits. KERS also provides health, death, and disability benefits. Benefits are established by state statute. Covered employees hired before September 1, 2008, are required by state statute to contribute 5% of their salary to KERS.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014
(Continued)

NOTE 10 - EMPLOYEE PENSION PLANS (CONTINUED)

Covered employees hired between September 1, 2008, and December 31, 2013, who retire at or after age 65 with a minimum of 60 months of credited service, or when the employee's age plus years of service credit equal 87 and they are at least 57 years of age, are entitled to an annual retirement benefit equal to 1.10% to 2.00% of their final-average salary multiplied by their years of service. Final average salary is the employee's average of the last five full fiscal years. The employee may also be eligible for a reduced retirement benefit at 60 years of age and a minimum of 120 months of credited service. The KERS also provides health, death, and disability benefits. Benefits are established by the State statute. Covered employees hired between September 1, 2008, and December 31, 2013, are required to contribute 5% of their salary to the plan and 1% to KERS Insurance Fund.

Covered employees hired after December 31, 2013, are eligible to participate in a cash balance plan which requires employee to pay a pre-tax 5% rate based on creditable compensation. The employee's account is also credited with a 4% employer pay credit. In addition to the 5% contribution, all active employees participating on or after January 1, 2014, pay a 1% pretax contribution to KERS Insurance Fund. At the end of each fiscal year, interest is paid into the employee's account. The account is guaranteed 4% interest credit on the employee's account balance as of June 30 of the previous year. The employee's account may be credited with additional interest if the five-year average investment return exceeds 4%. At the time of termination, the employee is eligible to either take a refund of the accumulated account balance if vested (five or more years of service), or annuitize their account balance, if eligible for retirement. If the employee terminates employment and requests a refund prior to vesting the employee is eligible for the employee's contributions and associated interest, and forfeits the employer pay credit and associated interest.

The KHBE is required by the same statute to contribute to the KERS. The required contribution made by the KHBE for the fiscal year 2014 was \$318,122.

The ten-year historical trend information showing KERS progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Employees Retirement System's Annual Financial Report. Additional disclosures related to the defined benefit plan are included in the Commonwealth of Kentucky's Comprehensive Annual Financial Report.

**KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014
(Continued)**

NOTE 11 - FEDERAL CONTRIBUTION

Section 1311 of the Patient Protection and Affordable Care Act makes grant funds available to all state-based exchanges, including KHBE, to assist them in planning, establishing, and operating their own state-based marketplaces. Consistent with this ACT, such federal 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.

NOTE 12 – SMALL BUSINESS HEALTH OPTIONS PROGRAM (SHOP)

The KHBE is required to establish and operate a SHOP exchange to assist qualified employers and facilitate the enrollment of qualified employees into QHPs (45 CFR 155.700). The SHOP Exchange is aimed at easing the administrative burden for employers that administer group health plans. Through the SHOP, employers are issued a single, aggregated monthly bill itemizing the health plan selected by each employee, the employer contribution, the employee contribution and the total amount due to each QHP issuer. The KHBE collects the premiums billed to the employers and then distributes those payments to the issuers.

NOTE 13 - SUBSEQUENT EVENTS

A statement of work (SOW) relating to continuing system development requirements for the SHOP was signed between KHBE and Deloitte in July 2014. The total SOW is \$17,550,000 and includes deliverables with due dates through June 2016. Retainage fees in accordance with the Deloitte Master Agreement apply to the charges, in addition to certain costs being allocated among the KHBE, Medicaid and KCHIP.

On December 17, 2014, the KHBE received a supplemental grant award in the amount of \$35,605,175 to support ongoing efforts pertaining to consumer and stakeholder engagement and support and technology. At the same time, the KHBE also received a no-cost extension on the KHBE's Level 2 Establishment Grant. This extension allows federal funds to be used for design, development and implementation activities through December 31, 2015, and for operational costs through March 31, 2015. Following the no-cost extension award, the federal government announced in February 2015 that the health benefit exchange will have a special enrollment period through April 30, 2015, for individuals affected by tax penalties. Since the federal government extended the open enrollment period for these special circumstances, the federal government is allowing the continuation of federal funds to be used for operational costs through the special enrollment period that ends April 30, 2015.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

KENTUCKY HEALTH BENEFIT EXCHANGE
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended June 30, 2014

CFDA	Program Title	Expenditures
<u>U.S. Department of Health and Human Services</u>		
93.525	State Planning and Establishment Grants for the Affordable Care Act (ACA)'s Exchanges	<u>\$ 79,088,272</u>
Total U.S. Department of Health and Human Services		<u>\$ 79,088,272</u>
Total Federal Awards		<u>\$ 79,088,272</u>

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NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

**KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2014**

Note 1 - Purpose of the Schedule and Significant Accounting Policies

Basis of Presentation - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*. The accompanying schedule includes all federal grant activity for the Kentucky Health Benefit Exchange (KHBE) and is presented primarily on the basis of cash disbursements as modified by the application of Kentucky Revised Statute (KRS) 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed.

KRS 45.229 provides that the Finance and Administration Cabinet may, “for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose.” However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

The basic financial statements of the KHBE are presented on the accrual basis of accounting. Therefore, the schedule may not be directly traceable to the basic financial statements in all cases.

Note 2 - Type A Programs

Type A programs for the KHBE mean any program for which total expenditures of federal awards exceeded \$2,372,648 for FY 2014. In FY 2014, CFDA 93.525 State Planning and Establishment Grants for the Affordable Care Act (ACA)’s Exchanges met the Type A program definition.

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**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***



ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

**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***

Audrey Tayse Haynes, Secretary
Cabinet for Health and Family Services
Carrie Banahan, Executive Director
Kentucky Office of Health Benefit and Health Information Exchange

Independent Auditor's Report

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 Kentucky Health Benefit Exchange (KHBE) as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise KHBE's basic financial statements, and have issued our report thereon dated March 13, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the KHBE'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the KHBE's internal control. Accordingly, we do not express an opinion on the effectiveness of the KHBE's internal control.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore,



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*
(Continued)

Internal Control Over Financial Reporting (Continued)

material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs, that we consider to be significant deficiencies as identified as finding 2014-001.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the KHBE's financial statements are free of 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*.

KHBE's Response to Findings

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

Additional Management Communication

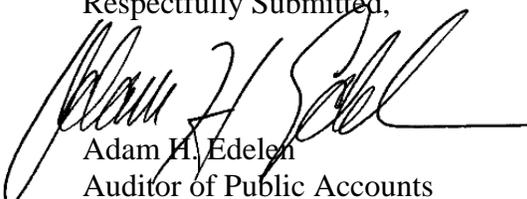
We noted certain matters that we have reported to management of the KHBE in a separate letter dated March 13, 2015.

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*
(Continued)

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 result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully Submitted,



Adam H. Edelen
Auditor of Public Accounts

March 13, 2015

**REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT
AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**



ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

Report On Compliance With Requirements
That Could Have A Direct And Material Effect On Each Major Program And On
Internal Control Over Compliance In Accordance With OMB Circular A-133

Audrey Tayse Haynes, Secretary
Cabinet for Health and Family Services
Carrie Banahan, Executive Director
Kentucky Office of Health Benefit and Health Information Exchange

Independent Auditor's Report

Report on Compliance for Each Major Federal Program

We have audited the Kentucky Health Benefit Exchange's (KHBE) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* that could have a direct and material effect on each of KHBE's major federal programs for the year ended June 30, 2014. KHBE's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the KHBE's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Not-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the KHBE's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.



Report On Compliance With Requirements
That Could Have A Direct And Material Effect On Each Major Program And On
Internal Control Over Compliance In Accordance With OMB Circular A-133
(Continued)

Auditor's Responsibility (Continued)

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

Opinion on Each Major Federal Program

In our opinion, the KHBE complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major programs for the year ended June 30, 2014.

Report on Internal Control Over Compliance

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

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Report On Compliance With Requirements
That Could Have A Direct And Material Effect On Each Major Program And On
Internal Control Over Compliance In Accordance With OMB Circular A-133
(Continued)

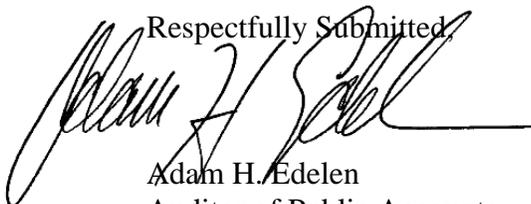
Additional Management Communication

We noted certain matters that we have reported to management of the KHBE in a separate letter dated March 13, 2015.

Purpose of this Report

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

Respectfully Submitted

A handwritten signature in black ink, appearing to read 'Adam H. Edelen', is written over the typed name and title.

Adam H. Edelen
Auditor of Public Accounts

March 13, 2015

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

**KENTUCKY HEALTH BENEFIT EXCHANGE
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2014**

SECTION 1 - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Financial Statements: We issued an unmodified opinion on the basic financial statements of the KHBE as of and for the year ended June 30, 2014.

Compliance: In relation to the audit of the basic financial statements of the KHBE, the results of our tests disclosed no instances of noncompliances that are to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting: Our consideration of the KHBE's internal control over financial reporting disclosed one significant deficiency.

Federal Awards

Compliance: We issued an unmodified opinion on the KHBE's compliance with the types of compliance requirements described in OMB Circular A-133 Compliance Supplement that could have a direct and material effect on each of the KHBE's major federal programs for the year ended June 30, 2014.

Internal Control Over Compliance: Our consideration of the KHBE's internal control over compliance did not disclose any significant deficiencies or material weaknesses.

Identification of Major Programs

Major Type A Programs

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

Dollar Threshold Used to Distinguish Between Type A and Type B Programs

The maximum dollar threshold used to distinguish between Type A and Type B programs was \$2,372,648.

Auditee Risk

The KHBE did not qualify as a low-risk auditee.

SECTION 2 - FINANCIAL STATEMENT FINDINGS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 2014-001: The Cabinet For Health And Family Services Caseworkers Incorrectly Merged Member Case Files Which Allowed Instances Of An Individual Other Than The Member Being Able To View Information**

During the fiscal year (FY) 2014 Cabinet for Health and Family Services audit, it was found that sufficient controls were not in place within the Kentucky Health Benefits Exchange (KHBE) Worker Portal module to ensure caseworkers only merged potential duplicate case files where sufficient data was matched. Due to the existence of incorrectly merged cases, there were instances identified where someone other than the member was able to view personal identifiable information (PII) through the KHBE user application, kynect.

During fieldwork, the auditors became aware of an individual who stated another individual's information was available to them after logging into their kynect account. This statement was made in an interview with a national news organization. Discussions with agency management identified that this particular situation was caused by a CHFS employee merging two unique cases in error. Upon further review by CHFS management after the merge, there was sufficient information in the data for the CHFS employee to have been able to determine the case files related to two unique individuals rather than the same person. There was no indication through this review that either sensitive or confidential data was viewed by either effected case member. These case files were subsequently separated.

In an attempt to determine whether other case files had been erroneously merged, CHFS management created a report that identified approximately 500 case files where a merge issue could potentially have occurred. This review found 321 case files, or approximately 64.2 percent, where the cases were inappropriately merged. Further, there were 14 cases, or approximately 2.8 percent, of those reviewed where information that would be considered sensitive or confidential was disclosed to an individual other than the case member.

Based on these findings, CHFS management began altering features within the system that would provide CHFS employees with tools to better assess whether duplicate cases exist and need to be merged or are unique and should be maintained separately. These tools include filtering for specific data matches and additional detailed information and comparison capabilities that would allow the CHFS employees to make more informed determinations. These changes were put into place in late February and March 2014. In addition, CHFS management is looking at other control options that would limit access to the merging capabilities in the system or require additional approval for case merges to be finalized.

Historically, individuals who are requesting eligibility determinations for service would meet with a CHFS Department of Community Based Services (DCBS) employee and provide all necessary information at that time. This direct interaction would allow the employee to better make the determination of whether there was an existing case within the system for the individual. Although direct interaction with DCBS employees is still an option, with the advent of the KHBE, individuals now also have the ability to enter their own personal information into the website. In the original concern

SECTION 2 - FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 2014-001: The Cabinet For Health And Family Services Caseworkers Incorrectly Merged Member Case Files Which Allowed Instances Of An Individual Other Than The Member Being Able To View Information (Continued)

discussed above, the problem occurred when one case file was developed through the KHBE and a second account with the same name was created at a DCBS office. The caseworker reviewing these case files determined erroneously that the two case files were for the same individual.

If case files are incorrectly merged, it is possible for an individual other than the member to view or alter PII related to the member.

Access to PII should be restricted to only the associated member and appropriate staff who must work with the data in order to provide the required services. Further, separate case files should be maintained for all unique individuals.

Recommendation

We recommend CHFS continue to monitor the effectiveness of the tools put in place to assess whether cases are duplicate and need to be merged or are unique and should be maintained separately. If these tools are not as effective as anticipated, CHFS management should consider additional process changes to ensure only true duplicate case files are merged.

Management's Response and Corrective Action Plan

CHFS concurs with the finding. KHBE continues to monitor the effectiveness of the tools put in place to assess whether cases are duplicate and need to be merged or are unique and should be maintained separately. CHFS has implemented the following modifications and monitoring processes to help identify and prevent potentially merged citizens:

- *Business rules for the programmatic identification and merging of duplicate cases were tightened*
- *Application changes were made to make the manual merging of cases more difficult and to require more reviews by caseworkers*
- *Additional training was conducted and job aids developed for caseworkers to clarify functionality and use of the KHBE system*
- *MCI Inspector Tool has been provided to help monitor the potential merge cases. This tool is monitored multiple times throughout the day.*

SECTION 3 – FEDERAL AWARD FINDINGS

No matters were reported.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

No matters were reported.

