

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

**For The Fiscal Year Ended
June 30, 2018**



**MIKE HARMON
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MIKE HARMON
AUDITOR OF PUBLIC ACCOUNTS

Adam Meier, Secretary
Cabinet for Health and Family Services
Robert Putt, Executive Director
Office of Health Data and Analytics

Independent Auditor's Report

Report on the Financial Statements

We have audited the accompanying basic financial statements of the Kentucky Health Benefit Exchange (KHBE), an enterprise fund of the Commonwealth of Kentucky, as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise KHBE's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

KHBE's 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 the basic 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 the 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 estimates made by management, as well as evaluating the overall presentation of the financial statements.



Adam Meier, Acting Secretary
Cabinet for Health and Family Services
Robert Putt, Acting Executive Director
Office of Health Data and Analytics

We believe 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 KHBE, as of June 30, 2018, and the respective changes in its financial position and its cash flows, for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter

Reporting Entity

As discussed in Note 1, the financial statements present only the KHBE, and are not intended to present fairly the financial position of the Commonwealth of Kentucky, or the results of its operations and cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Change in Accounting Principle

As discussed in Note 1, the Authority implemented Governmental Accounting Standards Board Statement (GASB) No. 75 *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, during fiscal year 2018. The implementation of this standard resulted in a prior period adjustment to the Authority's Net Position at July 1, 2017. Our opinion is not modified with respect to this matter.

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 7 to 11, the Schedule of Proportionate Share of the Net Pension Liability, the Schedule of Proportionate Share of the Net OPEB Liability and the related Schedule of Contributions on pages 43 to 46 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.

Adam Meier, Acting Secretary
Cabinet for Health and Family Services
Robert Putt, Acting Executive Director
Office of Health Data and Analytics

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 16, 2019, 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 the KHBE's 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 KHBE's internal control over financial reporting and compliance.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Mike Harmon", with a long horizontal line extending to the right.

Mike Harmon
Auditor of Public Accounts

April 16, 2019

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, 2018, to assist the reader in an assessment of the financial condition of KHBE. Please assess this narrative and analysis in conjunction with 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. 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. Subsequent executive orders issued each year thereafter continued the establishment and operation of KHBE.

Through December 2016, KHBE facilitated the purchase and sale of health plans in the individual market; assisted small employers in facilitating the enrollment of their employees in health plans; provided one-stop shopping by also helping individuals enroll in Medicaid and Kentucky Children's Health Insurance Program (KCHIP) health plans; enabled individuals to receive premium tax credits, premium subsidies, and reduced cost sharing; and qualified small business for tax credits. Kentucky's health benefit exchange was trademarked as "kynect" and referred to as "kynect" or KHBE. Open enrollment in KHBE occurred annually during the months of November through January. Open enrollment for 2016 was the final annual enrollment period provided through the kynect platform. Starting in January 2017, the enrollment and eligibility platform used in Kentucky for Qualified Health Plans and SHOP was HealthCare.gov.

The "No Wrong Door" approach was 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 Qualified Health Plans (QHP), Medicaid, and Kentucky Children's Health Insurance Program (KCHIP) 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 KHBE, Medicaid and KCHIP based on the federally approved CAP while costs strictly associated with one program are not cost allocated with others. The kynect program was decommissioned on January 1, 2017, and the eligibility and enrollment function transitioned to the federal exchange at that time. Some consumer assistance and plan management activities were still performed by KHBE. Kynect SHOP continued to assist SHOP groups until their 2016 plan year ended.

FUNDING

KHBE's funding, to establish "kynect" and fund operations through June 30, 2017, is provided through federal grants awarded by the Department of Health and Human Services (HHS) and restricted funds received from a broad-based premium assessment. The federal grants awarded by HHS include:

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

- 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; and
- Level 2 Establishment Grant, \$182,707,738, awarded January 16, 2013 with a supplemental award of \$35,605,175 on December 17, 2014.
- A post-award amendment on August 11, 2016 reducing the total award by \$21,670,360, with a further de-obligation of \$2,525,758 in funds on December 5, 2016.
- A post-award amendment on March 7, 2018 reducing the total award amount by \$2,213,458, thus closing out all award activity with the final award amount total of \$191,903,336.

The ACA requires each state to ensure that its Exchange has sufficient funding in order to support its ongoing operations beginning January 1, 2015, which coincided with when open enrollment for the 2015 plan year was scheduled to end. However, with the federal government extending the 2015 plan year open enrollment period into 2015, KHBE received HHS approval to continue using federal grant funds until April 30, 2015 for operational expenses. Beginning May 1, 2015, federal grant funds could not be used for operational expenses and were only allowed for design, development and implementation activities. KHBE's on-going funding is through a broad-based premium assessment on all issuers offering health benefit plans and stop loss policies. KHBE did not receive any state general fund appropriations.

The Commonwealth of Kentucky's biennium budget for state fiscal years (SFY) 18 and 19 was approved by the General Assembly in the spring of 2018. Approved within the biennium budget of KHBE was revenue derived from a 1% broad based premium assessment. SFY 2019 revenue projections generated from a 1% broad based assessment are estimated at \$31.7 million.

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 Accounting Standards Board (GASB). These financial statements and related note disclosures are designed to provide an overview of KHBE's financial position and activities.

Statement of Net Position – The Statement of Net Position presents information on KHBE's assets, liabilities, and net position. Over time, net position can serve as a useful indicator whether the financial position of KHBE is improving or deteriorating. As of June 30, 2018, the statement reflects assets of \$24,135,246 with capital assets representing approximately 99% of the total assets due to the development of "kynect." The most significant portion of liabilities was net pension & OPEB liabilities of \$9,550,657, which represented 98% of total liabilities. This liability is the proportionate share of the collective net pension liability determined by an actuarial valuation as of June 30, 2017. Table 1 presents KHBE's condensed Statement of Net Position as of June 30, 2018, and June 30, 2017, derived from the Statement of Net Position for the respective years with a restatement to Fiscal Year 2017 due to the recognition of a net OPEB liability per GASB No.75 (see Note 10).

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

FINANCIAL STATEMENTS (CONTINUED)

**Table 1
Condensed Statement of Net Position
As of June 30**

	2018	2017 (Restated)	Percentage Increase (Decrease)
Current Assets	\$ 7,627	\$ 400,924	(0.98) %
Non-Current Assets	42,373	603,848	(0.93)
Capital Assets	24,085,246	25,637,595	(0.06) %
Total Assets	<u>24,135,246</u>	<u>26,642,367</u>	<u>(0.09) %</u>
Deferred Outflows of Resources	1,971,033	1,935,114	0.02 %
Current Liabilities	144,597	795,874	(0.82) %
Noncurrent Liabilities	9,551,947	9,943,261	(0.04) %
Total Liabilities	<u>9,696,544</u>	<u>10,739,135</u>	<u>(0.10) %</u>
Deferred Inflows of Resources	1,438,473	57,863	23.86 %
Net investment in Capital Assets	24,085,246	25,633,058	(0.06) %
Unrestricted	(9,113,984)	(7,852,574)	0.16 %
Total Net Position	<u>\$ 14,971,262</u>	<u>\$ 17,780,484</u>	<u>(0.16) %</u>

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, 2018. The difference (increase or decrease) is presented as the change in net position. Operating revenue totaled \$2,687,522 and operating expenses were \$5,496,675 with a non-operating expense of \$69 resulting in a net position decrease of \$(2,809,222) for state fiscal year ending 2018. Table 2 provides a summary of KHBE's revenue, expenses, and change in net position as of June 30, 2018 and June 30, 2017, as restated.

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

FINANCIAL STATEMENTS (CONTINUED)

**Table 2
Condensed Statement of Revenues, Expenses
and Changes in Net Position**

	2018	2017 (Restated)	Percentage Increase (Decrease)
Total Operating Revenues	\$ 2,687,522	\$ 17,004,500	(0.84) %
Total Operating Expenses	5,496,675	22,029,447	(0.75) %
Total Non-Operating Expenses	69	1,278	(0.95) %
Change in Net Position	<u>(2,809,222)</u>	<u>(5,026,224)</u>	<u>(0.44) %</u>
Net Position at July 1, 2017, As Restated	17,780,484	22,806,708	(0.22) %
Net Position at June 30, 2018	<u>\$ 14,971,262</u>	<u>\$ 17,780,484</u>	<u>(0.16) %</u>

Statement of Cash Flows – The Statement of Cash Flows presents information showing 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.

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

ECONOMIC FACTORS

The decision of the Governor of the Commonwealth of Kentucky to transition from a State-based Marketplace to a State-Based Marketplace using the Federal Platform (SBM-FP) will affect future KHBE financial statements. As a result of scaling back operational activities, departmental expenditures have decreased. As an SBM-FP, Kentucky's exchange collects an assessment from the Commonwealth of Kentucky issuers participating on the Federal Platform.

CURRENTLY KNOWN FACTS, DECISIONS OR CONDITIONS

On December 30, 2015, the Governor of the Commonwealth of Kentucky notified HHS of the Commonwealth's intention to wind down and cease operations of the Commonwealth's State Based Exchange "kynect" and transition to the Federal Exchange as soon as practical. Staff worked on the transition throughout 2016 so that Kentuckians would be prepared and informed of the transition during the open enrollment for 2017. Effective January 1, 2017, the Commonwealth transitioned to the Federal Exchange. Additionally, kynect SHOP also has transitioned to the Federal exchange.

CONTACTING KHBE'S MANAGEMENT

KHBE's financial statements are designed to provide a general overview of the KHBE's finances. Additional information regarding KHBE's financial statements may be obtained from: Kentucky Office of Health Data and Analytics, Division of Benefit Exchange, 275 E Main St 4w-e, Frankfort, KY 40621.

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FINANCIAL STATEMENTS

**KENTUCKY HEALTH BENEFIT EXCHANGE
STATEMENT OF NET POSITION**

June 30, 2018

Assets

Current Assets:

Cash (Note 2)	\$	7,627
Total Current Assets		7,627

Non-current Assets:

Long-Term Investments (Note 2)		42,373
Capital Assets (Note 4)		
Machinery and equipment		171,411
Software		30,776,904
Less: Accumulated depreciation and amortization		(6,863,069)
Total Capital Assets:		24,085,246
Total Non-current Assets		24,127,619
Total Assets		24,135,246

Deferred Outflows of Resources		1,971,033
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Liabilities

Current Liabilities:

Accounts payable (Note 3)		120,080
Compensated absences (Note 8)		24,517
Total Current Liabilities		144,597

Non-current Liabilities

Compensated absences (Note 8)		1,290
Net Other Post-Employment Benefits Liability (Note 10)		1,634,231
Net Pension Liability (Note 9)		7,916,426
Total Non-current Liabilities		9,551,947

Total Liabilities		9,696,544
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Deferred Inflows of Resources		1,438,473
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Net Position

Net investment in capital assets		24,085,246
Unrestricted		(9,113,984)
Total Net Position	\$	14,971,262

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, 2018

Operating Revenues:	
Federal grants	\$ 146,847
Small business health option program premiums	64,939
Assessment fees from Ky Access	2,475,736
Total Operating Revenues	<u>2,687,522</u>
Operating Expenses:	
Personnel and contracted services	2,842,649
Utilities, rental, and other services	985,590
Commodities and supplies	27,904
Depreciation and amortization	1,552,349
Small business health option program payments	81,728
Travel	6,455
Total Operating Expenses	<u>5,496,675</u>
Operating Income (Loss)	(2,809,153)
Non-Operating Revenues (Expenses)	
Interest Expense	(69)
Total Non-Operating Revenues (Expenses)	<u>(69)</u>
Income (Loss)	(2,809,222)
Net Position at July 1, 2017 (restated)	<u>17,780,484</u>
Net Position at June 30, 2018	<u>\$ 14,971,262</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, 2018

Cash flows from operating activities:	
Cash received from Small business health option program	\$ 64,940
Cash received from federal grants	475,883
Cash payments for personnel and contracted services	(2,356,119)
Cash payments for goods and services	(1,047,922)
Cash payments to other sources	(162,581)
Cash Payments from other sources	2,476,558
Net cash provided (used) by operating activities:	<u>(549,241)</u>
Cash flows from capital and related financing activities:	
Principal paid on revenue bond maturities and equipment contracts	(4,537)
Interest paid on revenue bond and equipment contracts	(69)
Net cash provided (used) for capital and related financing activities	<u>(4,606)</u>
Cash flows from investing activities:	
Purchase of investment securities	561,474
Net cash used in investing activities	<u>561,474</u>
Net change in cash and cash equivalents	7,627
Cash and cash equivalents at July 1, 2017	
Cash and cash equivalents at June 30, 2018	<u>\$ 7,627</u>
Reconciliation of income from operations to net cash flows from operating activities:	
Operating income (loss)	\$ (2,809,153)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:	
Depreciation and amortization	1,552,349
Decrease (increase) in assets:	
Federal grants receivable, net	329,038
Intergovernmental receivable, net	56,748
Prepaid Expenses	15,141
Deferred Outflows of Resources	(35,918)
Increase (decrease) in liabilities:	
Accounts payable	(485,790)
Intergovernmental payable	(74,160)
Pension & OPEB Liability	(368,099)
Compensated absences	(110,004)
Deferred Inflows of Resources	1,380,610
Net cash provided (used) by operating activities:	<u>\$ (549,241)</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, 2018

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 KHBE's financial statements. The financial statements and notes are representations of 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.

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. 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. Through December 2016, KHBE facilitated the purchase and sale of health plans in the individual market; assisted small employers in facilitating the enrollment of their employees in health plans; provided one-stop shopping by also helping individuals enroll in Medicaid and Kentucky Children's Health Insurance Program (KCHIP) health plans; enabled individuals to receive premium tax credits, premium subsidies, and reduced cost sharing; and qualified small business for tax credits. Open enrollment in KHBE occurred annually during the months of November through January. Open enrollment for 2016 was the final annual enrollment period provided through the kynect platform. Subsequent executive orders issued each year thereafter continued the establishment and operation of KHBE.

Federal grant funding financed KHBE design, development, and implementation phases, as well as operations through April 30, 2015. KHBE, trademarked as "kynect," was required to be financially self-sustaining using a broad-based premium assessment on all issuers offering health benefit plans and stop loss policies. KHBE did not receive any state general fund appropriations.

The "No Wrong Door" approach was 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 Qualified Health Plans (QHP), Medicaid, and Kentucky Children's Health Insurance Program (KCHIP) 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 were allocated among the KHBE, Medicaid and KCHIP based on the federally approved CAP while costs strictly associated with one program were not cost allocated with others. The kynect program was decommissioned on January 1, 2017 and the eligibility and enrollment functions have transitioned to the federal exchange. Some consumer assistance and plan management activities will continue to be performed by KHBE. Kynect SHOP continued to assist SHOP groups until their 2016 plan year ended.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reporting entity and basis of presentation – The accompanying financial statements have been prepared in conformity with the United States 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. KHBE has adopted the Governmental Accounting Standards Board (GASB) pronouncements, which is the accepted standard governing body for establishing governmental accounting financial reporting principles nationally. KHBE has no relationship with other entities that could be considered component units.

Cash and equivalents – 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.

Capital Assets

Purchased capital assets are reported at cost. During 2018, no hardware or software assets were purchased by KHBE under contract with Deloitte Consulting using Level 2 Establishment Grant funds and Medicaid funds.

The policy of KHBE is to capitalize assets when the useful life is greater than one year and the acquisition cost meets the capitalization threshold. The primary government'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, 2018.

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.

Depreciation on all assets is provided on the straight-line basis over the following 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

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Contracts Holdback Liability

All KHBE contracts contain 30 day cancellation clauses that can be exercised for the convenience of the Commonwealth.

Contract MA 758 1300000392, effective October 3, 2012, with Deloitte Consulting LLP, was executed for the purpose of purchasing systems integrator services to develop and implement a Health Benefit Exchange System. Under the contract, the Commonwealth was required to retain a holdback of 12.5% of the purchase price for each deliverable based on the original contract terms and additional Statements of Work. The contract requirements were satisfied, all holdback payments were made to the vendor, and KHBE no longer reflects a balance of contract holdback at the end of FY 2018.

Pensions

For purposes of measuring the net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense relate to the pension plan. Information about the fiduciary net position of the Kentucky Retirement System (KRS) and addition to/deductions from KRS's fiduciary net position have been determined on the same basis as they are reported by KRS. (See Note 9)

Other Post-Employment Benefits

For purposes of measuring the net Other Post-Employment Benefits (OPEB) liability, deferred outflows of resources, deferred inflows of resources, and OPEB expense relate to the Other Post-Employment Benefits plan. Information about the fiduciary net position of the Kentucky Retirement System (KRS) and addition to/deductions from KRS's fiduciary net position have been determined on the same basis as they are reported by KRS. (See Note 10)

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:

1. **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.
2. **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.
3. **Unrestricted net position** are those net positions that do not meet the definition of restricted net position or net investment in capital assets.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

When restricted assets and unrestricted assets are both available for a particular purpose, 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 revenue and expense – 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 – 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. 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.

Changes in Accounting Principles, Reporting Practices, and Prior-Period Adjustments

GASB Statement No. 75 – Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions was adopted and implemented during the fiscal year.

This statement establishes general principles for disclosing information about the accounting and financial reporting for Postemployment Benefits Other Than Pensions that is provided to the employees of the state and local governmental employers. All applicable provisions of this new statement have been incorporated into the Notes to the Financial Statements.

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. KHBE was included in the pooling of cash during fiscal year 2018, and therefore, follows the Commonwealth's policies for all pooled cash and investments. The risk disclosures related to deposits and investments are reported in the Commonwealth of Kentucky's Comprehensive Annual Financial Report (CAFR). As of June 30, 2018, the carrying value of KHBE's pooled cash and cash equivalents totaled \$7,627 and the fair value of KHBE's investments was \$42,373, for a net combined positive total fair value of \$50,000. In accordance with the implementation of GASB No. 72, the KHBE assets are measured as Level 2 within the fair value hierarchy. Please refer to the Commonwealth's CAFR for further information and disclosure.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 3 - ACCOUNTS PAYABLE

Accounts payable are amounts owed by KHBE as of June 30, 2018. The liabilities will be paid within one year and therefore considered current. The following table shows the disaggregation of the amounts reported as accounts payable for as of June 30, 2018.

<u>Current Payables</u>	
Personal Services	\$ 116,614
Other	3,466
Total Current Payables	<u>\$ 120,080</u>

NOTE 4 - CAPITAL ASSETS

Capital assets consist of the following at June 30, 2018:

	<u>Balance</u> <u>June 30, 2017</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2018</u>
Assets:				
Equipment and Machinery	\$ 171,411	\$	\$	\$ 171,411
Software	30,776,904			30,776,904
Total All Asset Types	<u>30,948,315</u>			<u>30,948,315</u>
Accumulated Depreciation:				
Equipment	(111,871)	(13,506)		(125,377)
Software	(5,198,848)	(1,538,844)		(6,737,692)
Total Accumulated Depreciation	<u>(5,310,719)</u>	<u>(1,552,350)</u>		<u>(6,863,069)</u>
Total Capital Assets, net	<u>\$ 25,637,596</u>	<u>\$ (1,552,350)</u>	<u>\$</u>	<u>\$ 24,085,246</u>

NOTE 5 - ONLINE MARKETPLACE DEVELOPMENT

During 2013, 2014, 2015 and 2016, KHBE incurred, respectively, \$19,001,243, \$5,354,421, \$6,552,548, (\$131,308) 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, 2018. There were no capitalized costs for FY 2017 and FY 2018.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 6 - 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 2 CFR 225 – Cost Principles for State, Local, and Indian Tribal Governments (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 KHBE to allocate a portion of qualifying expenditures to Medicaid and KCHIP at a pre-agreed upon rate. Subsequently, KHBE worked to discuss, review, and determine the cost allocation methodology for any Medicaid/KCHIP eligible expenditures. On March 20, 2012 the Center for Medicare and Medicaid Services (CMS) approved KHBE 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. Updates to the I-APD have been submitted on an annual basis to CMS for continued approval of the project’s design, development, and implementation activities.

NOTE 7 - COMMITMENTS

During fiscal year 2018, the Commonwealth renewed and entered into numerous contract agreements relating to the development and operations of KHBE. Any agreements that exceed KHBE’s current grant period are contingent upon future grant approval and the broad-based premium assessment levels.

Office lease – KHBE has entered into an agreement to lease office space in Frankfort, Kentucky with the commencement date for each corresponding to the 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. KHBE office lease space is cost allocated among benefiting programs. KHBE spent \$184,669 for fiscal year ending June 30, 2018.

Vendor Contracts – 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 30 days of notice totaled approximately \$11.2 million as of June 30, 2018. These long-term obligations represent the total amounts and include expenses that will be cost allocated to Medicaid and KCHIP.

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 KHBE.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 8 - COMPENSATED ABSENCES

The policy of the Commonwealth of Kentucky is to record the cost of annual and compensatory leave. Annual leave accumulates 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 KHBE as of June 30, 2018, are:

	Beginning			Ending	Due Within
	<u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u>	<u>One Year</u>
Annual Leave	\$ 79,739	\$ -	\$ 60,343	\$ 19,396	\$ 18,426
Compensatory Leave	56,072	-	49,661	6,411	6,091
Total	<u>\$ 135,811</u>	<u>\$ -</u>	<u>\$ 110,004</u>	<u>\$ 25,807</u>	<u>\$ 24,517</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, 2018. The estimated accumulated unused sick leave for the KHBE employees at June 30, 2018 was \$58,575.

NOTE 9 - PENSION PLANS

Under the provisions of Kentucky Revised Statutes (KRS) 61.645, the Board of Trustees of the Kentucky Retirement Systems administers the Kentucky Employees Retirement System (KERS).

The Commonwealth contributes to the KERS, a multiple-employer cost sharing defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous and hazardous duty positions of any state department, board, or any agency directed by Executive Order to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of the plan members under certain circumstances.

The financial statements are prepared using the accrual basis of accounting which is the same method used by all retirement plans of the Commonwealth. Plan member contributions are recognized in the period in which contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with terms of the plan.

Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national exchange are valued at the last reported sales price at current exchange rates. The fair value of real estate is based on appraisals. Investments that do not have an established market are reported at estimated fair value.

The Kentucky Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the above mentioned retirement systems. That

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 9 - EMPLOYEE PENSION PLANS (CONTINUED)

report may be obtained by writing the Kentucky Retirement System, 1260 Louisville Road, Frankfort, Kentucky 40601-6124, or by telephone at (502) 564-4646 or online at www.kyret.ky.gov.

Kentucky Employees Retirement System
Governance KRS 61.510 through KRS 61.705
Cost Sharing Multiple Employer Defined Benefit
Non-Hazardous

	Tier 1 Participation Prior to 9/1/2008	Tier 2 Participation 9/1/2008 through 12/31/2013	Tier 3 Participation on or after 1/1/2014
Covered Employees:	Substantially all regular full-time members employed in non-hazardous and hazardous duty positions of any state department, board, or any agency directed by Executive Order to participate in the system.		
Benefit Formula:	Final Compensation X Benefit Factor X Years of Service		Cash Balance Plan
Final Compensation:	Average of the highest 5 fiscal years (must contain at least 48 months). Includes lump-sum compensation payments (before and at retirement).	5 complete fiscal years immediately preceding retirement; each year must contain 12 months. Lump-sum compensation payments (before and at retirement) are not to be included in creditable compensation.	No Final Compensation
Benefit Factor:	1.97%, or 2.0% for those retiring with service for all months between 1/1998 and 1/1999.	10 years or less = 1.10%. Greater than 10 years, but no more than 20 years = 1.30%. Greater than 20 years, but no more than 26 years = 1.50%. Greater than 26 years, but no more than 30 years = 1.75%. Additional years above 30 = 2.00% (2.00% benefit factor only applies to service earned in excess of 30 years).	No benefit factor. A life annuity can be calculated in accordance with actuarial assumptions and methods adopted by the board based on member's accumulated account balance.
Cost of Living Adjustment (COLA):	No COLA unless authorized by the Legislature with specific criteria. This impacts all retirees regardless of Tier.		
Unreduced Retirement Benefit:	Any age with 27 years of service. Age 65 with 48 months of service. Money Purchase for age 65 with less than 48 months based on contributions and interest.	Rule of 87: Member must be at least age 57 and age plus earned service must equal 87 years at retirement to retire under this provision. Age 65 with 5 years of earned service. No Money Purchase calculations.	
Reduced Retirement Benefit:	Reduced by 6.5% per year for the first 5 years and 4.5% per year for the next 5 years for each year the member is younger than age 65 or has less than 27 years of service, whichever is smaller.	Reduced by 6.5% per year for the first 5 years and 4.5% per year for the next 5 years for each year the member is younger than age 65, or does not meet the rule of 87 (age plus service) and is younger than age 57, whichever is smaller.	No reduced retirement benefit

**KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)**

NOTE 9 - EMPLOYEE PENSION PLANS (CONTINUED)

All full time employees of KHBE who work more than 100 hours per month participate in a multiple-employer cost sharing defined benefit pension plan. The Kentucky Employees Retirement System (KERS), Kentucky Employee Retirement Non- Hazardous Plan is administered by the Board of Trustees of the Kentucky Retirement Systems. The plan provides retirement, health, disability, and death benefits to plan participants. Cost-of-living adjustments are provided at the discretion of the State Legislature. Employees contribute 5% if participants are in Tier 1 and 6% for all other tiers of creditable compensation. The Board of Trustees determines employer contribution rates necessary for the actuarial soundness of the retirement system as required by Kentucky Revised Statutes 61.510 to 61.705. The employer contribution is subject to approval by the Kentucky General Assembly through the adoption of the Biennial Executive Branch Budget. At June 30, 2018, KHBE reported a liability of \$7,916,426 for its proportionate share of the collective net pension liability. The collective net pension liability was measured as of June 30, 2017, and the total pension liability was determined by an actuarial valuation as of the same date.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 9 - EMPLOYEE PENSION PLANS (CONTINUED)

	<u>Health Benefit Exchange</u>
Employer Contribution	41.06%
State Contribution as a percentage of nonemployer special funding situation	
Member Contribution	Tier 1: 5% Tier 2&3: 6%
Employer Contributions made in thousands	\$ 374,808
Actuarial Valuation Date	June 30, 2016, with standard roll forward
Measurement Date	June 30, 2017
Actuarial Cost Method	Entry age normal
Amortization Method	Level percent of pay
Asset Valuation Method	20% of the difference between the market value of assets and the expected actuarial value of assets is recognized
Investment Rate of Return	5.25%, decrease from 6.75%
Inflation Rate	2.3% decrease from 3.25%
Payroll Growth Assumptions	0.00% decrease from 4.00%
Projected Salary Increases	KERS Non-Hazardous active member salaries are assumed to increase at the rate of 19.5% in year one and decreasing to 3.55% for year ten and beyond.
Mortality Tables	RP-2000 Combined Mortality Table, projected to 2013 with scale BB (set back one year for females)
Date of Experience Study	The period July 1, 2008 - June 30, 2013
Update procedures applied	The total pension liability was rolled forward from the valuation date to the fiscal year-end June 30, 2017, using generally accepted actuarial principles.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 9 - EMPLOYEE PENSION PLANS (CONTINUED)

The long-term expected return on plan assets is based on an actuarial valuation performed as of June 30, 2016. The pension liability was rolled forward from the valuation date to the fiscal year end June 30, 2017 using generally accepted actuarial principles. Several factors are considered in evaluating the long-term rate of return assumption including long-term historical data, estimates inherent in current market data, and a log – normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not be useful in setting the long-term rate of return for funding pension plans which covers a longer timeframe. The assumption is intended to be a long-term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years.

The target asset allocation and best estimates of arithmetic nominal rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Nominal Rate of Return</u>
U.S. Equity	17.50%	5.75%
International Equity	17.50%	7.38%
Global Bonds	10.00%	2.63%
Global Credit	17.00%	3.63%
Real Estate	5.00%	6.63%
Absolute Return	10.00%	5.63%
Real return	10.00%	5.13%
Private Equity	10.00%	8.25%
Cash	3.00%	1.88%
Total	<u>100%</u>	

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 9 - EMPLOYEE PENSION PLANS (CONTINUED)

The discount rate used to measure the total pension liability of KHBE (KERS non-hazardous) was 5.25%, a decrease from 6.75%. The projection of cash flow used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate in all future years. Contributions are projected to be sufficient to finance all the future benefit payments of the current plan members. The discount rate determination does not use a municipal bond rate. The following presents the net pension liability of KHBE calculated using the discount rate of 5.25%, and as well as what the net position liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher.

Non-Hazardous			
	1% Decrease (4.25%)	Current Discount Rate (5.25%)	1% Increase (6.25%)
Net Pension Liability	\$ 9,038,763	\$ 7,916,426	\$ 6,983,258

For the Year Ended June 30, 2018, KHBE recognized pension expenses of \$1,075,674 and deferred outflows and deferred inflows related to pensions are from the following sources:

	<u>Deferred Outflows of</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 1,408	\$
Changes in assumptions	1,004,390	50,978
Net difference between projected and actual earnings on investment	98,934	60,653
Change in proportionate share	146,324	1,291,675
Contributions subsequent to the measurement date	407,485	
Total	<u>\$ 1,658,541</u>	<u>\$ 1,403,306</u>

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 9 - EMPLOYEE PENSION PLANS (CONTINUED)

The \$407,485 reported as deferred outflows of resources related to pensions resulting from contributions after the measurement date will be recognized as a reduction of net pension liability during the year ended June 30, 2019. Other amounts reported as deferred outflows and deferred inflows related to pensions will be recognized as pension expense as follows:

Year ended June 30:		
2019	\$	48,234
2020		(200,319)
2021		10,738
2022		(10,902)

NOTE 10 - OTHER POST EMPLOYMENT BENEFITS

Kentucky Revised Statutes (KRS) 61.701, created a trust fund known as “Kentucky Retirement Systems insurance trust fund.” It is a cost sharing OPEB plan. Contribution rates for employer and employees are established by Kentucky Statutes. Trust fund assets are dedicated for use for health benefits as provided in KRS 61.702, and as permitted under 26 U.S.C. secs. 105 and 106, to retired recipients and employees of employers participating in the Kentucky Employees Retirement System and State Police Retirement System, and to certain of their dependents or beneficiaries, including but not limited to qualified beneficiaries as described in 42 U.S.C. secs. 300bb-1 et seq. The employers participating in the trust fund are limited to the Commonwealth, political subdivisions of the Commonwealth, and entities whose income is exempt from taxation under 26 U.S.C. sec.115.

The board of trustees of the Kentucky Employees Retirement System administers the trust fund and the board serves as trustee of the fund. The board manages the assets of the fund in the same manner in which it administers the retirement funds, except that separate accounting and financial reporting shall be maintained for the trust fund. The financial reports can be obtained by writing the Kentucky Retirement System, 1260 Louisville Road, Frankfort, Kentucky 40601-6124 or by telephone at (502)564-4646 or on-line at www.kyret.ky.gov.

At June 30, 2018 KHBE reported a liability of \$1,634,231 for its proportionate share of the collective Net OPEB Liability. The liability measured as of June 30, 2017 and the Total OPEB Liability was determined by an actuarial valuation as of the same date.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

Governance KRS 61.701 to 61.705
Cost Sharing Multi-Employer Defined Benefit

Plan Administrator: The plan is administered by Kentucky Retirement Systems (KRS).

Covered Employees: Members of KRS currently receiving retirement benefits.

	Participation prior to July 2003		Participation between July 2003 and August 2008		Participation on or after September 2008	
	Months of Service	Percent of premium paid	Months of Service	Percent of premium paid	Months of Service	Percent of premium paid
Benefit Factor:	<48	0%	Greater than or equal to 120	\$10 per month for each year of service without regard to a maximum dollar amount, adjusted by 1.5% annually	Greater than or equal to 180	\$10 per month for each year of service without regard to a maximum dollar amount, adjusted by 1.5% annually
	48 to 119 inclusive	25%				
	120 to 179 inclusive	50%				
	180 to 239 inclusive	75%				
	240 or more	100%				

Contribution Rate: Contribution rates for the employer are actuarially determined. No member contribution. Contribution rates for the employer are actuarially determined. No member contribution. Contribution rates for the employer are actuarially determined. Member contribution of 1% of salary.

Cost of Living Adjustment (COLA): Members participating after 2008 receive 1.5% increase annually.

Employer Contribution: 8%

Membership:	
Retirees and beneficiaries receiving benefits	28,612
Inactive members	6,362
Active plan members	37,623
Total	72,597

Publicly available financial report can be accessed at www.kyret.ky.gov.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 10 - OTHER POST EMPLOYMENT BENEFITS (CONTINUED)

	<u>Kentucky Employees OPEB Plan (non-hazardous)</u>
Employer Contribution	8.67%
Member Contribution	1.00%
Contributions	\$ 98,522
Proportion share of Collective Liability	
As of Percentage	0.0644%
As a dollar amount	\$ 1,634,231
Experience Study	July 1, 2008-June 30, 2013
Actuarial Valuation Date	June 30, 2016
Inflation	2.30%
Salary Increases	0%. A change from 4.00% prior year.
Investment rate of return	6.25%. A change from 7.5% prior year.
Sharing Benefit Cost	The contribution has been adjusted to include the implicit rate subsidy. The health care plan blended rates are based on the combined experience of active and retired members. Because the average cost of providing health care benefits to retirees under age 65 is higher than the average costs of providing health care benefits to all participants. Resulting in an implicit rate subsidy for the non-Medicare retirees. Because the implicit subsidy does not pass through the trust, it is considered a benefit payment that was paid "as it becomes due."
Health cost trend rates	Underlying assumptions: 1). A short run period-this is a period for which anticipated health care trend rates are manually set based on local information as well as plan-specific and carrier information. 2). Long term real GDP Growth- 1.75%. 3). Long term rate of inflation- 2.3%. 4). Long term nominal GDP growth- 4.05%. 5). Year that excess rate converges to 0-15 years from the valuation. Health Care Cost Trends are thus the manually set rates for the short run period and rates which decline to an ultimate trend rate which equals the assumed nominal long term GDP growth rate.
Actuarial Cost Method	Entry age normal, Level percentage of pay
Asset valuation method	5 years smoothing
Actuarial assumptions:	
Investment rate of return	6.25%
Mortality Tables	The mortality table used for active members is RP-2000 Combined Mortality Table projected with scale BB to 2013 (multiplied by 50% for males and 30% for females.) Post retirement mortality (non-disabled) used RP-2000 Combined Mortality Table projected with Scale BB to 2013. Set back one year for females. Post-retirement disabled members RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 Male mortality rates set back four years for male.
Update procedures applied	The actuarial valuation date of June 30, 2016 was rolled-forward from the valuation date to the plan's fiscal year ending June 30, 2017 using standard roll forward procedures .

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 10 - OTHER POST EMPLOYMENT BENEFITS (CONTINUED)

The long-term expected rate of return was determined using a building block method in which best-estimate ranges of expected future real rate of returns are developed for each asset class. The ranges are combined by weighting the expected future real rate of return by the target asset allocation percentage. The target allocation and best estimates of arithmetic real rate of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Nominal Rate of Return
U.S. Equity	17.50%	5.97%
International Equity	17.50%	7.85%
Global Bonds	4.00%	2.63%
Global Credit	2.00%	3.63%
High Yield	7.00%	5.75%
Emerging Market debit	5.00%	5.50%
Private Credit	10.00%	8.75%
Real Estate	5.00%	7.63%
Absolute Return	10.00%	5.63%
Real return	10.00%	6.13%
Private Equity	10.00%	8.25%
Cash	2.00%	1.88%
Total	100%	

The discount used to measure the total OPEB liability was 5.83%. The single discount rate is based on the expected rate of return on OPEB plan investments of 6.25% and a municipal bond rate of 3.56% was used. Fidelity Index's "20-Year Municipal Go AA Index" as of June 30, 2017. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that employer contribution will be at the actuarial contribution rate. Based on those assumptions, the plan's fiduciary net position was projected to be sufficient to pay benefits payments of the retirement system. However, the cost associated with the implicit employer subsidy is not currently being included in the calculation of the plans actuarial determined contributions, and the subsidy will not be paid out of the System's trust. The following presents the net OPEB liability calculated using a discount as well as what the liability would be if it were using a discount rate that is 1% point lower or 1% point higher than the current rate:

	1% Decrease	Current Discount Rate	1% Increase
	4.83%	5.83%	6.83%
Net OPEB Liability	\$ 1,910,613	\$ 1,634,231	\$ 1,404,540

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 10 - OTHER POST EMPLOYMENT BENEFITS (CONTINUED)

The following table presents the new OPEB liability of the KRS OPEB Plan calculated using a healthcare cost trend rate that is 1% point lower or 1% point higher than the current rate:

	<u>1% Decrease</u>	Current Healthcare Cost Trend Rate <u>Current Rate</u>	<u>1% Increase</u>
Net OPEB Liability	\$ 1,388,567	\$ 1,634,231	\$ 1,942,705

Healthcare Trend Rates (Pre-65)	Initial trend starting at 7.50% and gradually decreasing to an ultimate trend rate of 5.00% over a period of 5 years.
Healthcare Trend Rates (Post-65)	Initial trend starting at 5.50% and gradually decreasing to an ultimate trend rate of 5.00% over a period of 2 years.

For the Year Ended June 30, 2018, HBE recognized OPEB expenses of \$162,117. Deferred outflows and deferred inflows related to OPEB are from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$	\$ 2,022
Changes in assumptions	213,970	
Net difference between projected and actual earnings on investments		21,152
Change in proportionate share		11,993
Contributions subsequent to the measurement date	98,522	
Total	<u>\$ 312,492</u>	<u>\$ 35,167</u>

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 10 - OTHER POST EMPLOYMENT BENEFITS (CONTINUED)

The \$98,522 reported as deferred outflows of resources related to OPEB resulting from contributions after the measurement date will be recognized as a reduction of net OPEB liability during the year ended June 30, 2019. Other amounts reported as deferred outflows and deferred inflows related to OPEB will be recognized as pension expense as follows:

Year ended June 30:	
2019	\$ 44,576
2020	44,576
2021	44,576
2022	44,576
2023	499

NOTE 11 - FEDERAL CONTRIBUTION

Section 1311 of the ACA 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 the ACA, such federal funds must be spent in accordance with grant requirements. KHBE received a federal extension to continue using federal grant funds for design, development and implementation activities through December 31, 2017. In addition, the ACA requires that state-based marketplaces be financially self-sustaining and as approved by the federal government; KHBE discontinued using federal funds for operational expenses beginning May 1, 2015.

NOTE 12 – SMALL BUSINESS HEALTH OPTIONS PROGRAM (SHOP)

KHBE was 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 was aimed at easing the administrative burden for employers that administer group health plans. Through the SHOP, employers were 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. KHBE collects the premiums billed to the employers and then distributes those payments to the issuers. The kynect SHOP program continued to assist SHOP groups until their 2016 plan year ended. All new SHOP groups were transitioned to the Federal exchange. Individual market eligibility and enrollments transitioned to the federal Platform during open enrollment for plan year 2017. Kynect SHOP enrollments for plan Year 2016 ended on or before November 30, 2017.

KENTUCKY HEALTH BENEFIT EXCHANGE
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2018
(Continued)

NOTE 13 – Prior-Period Restatements

Prior Period Error

Ending FY 2017 net position as previously reported has been restated due to a prior year error. The effect on the FY 2018 beginning net position is a decrease of \$168,176.

Change in Accounting Principle

The fund balances/net positions as previously reported have been restated or reclassified to conform to generally accepted accounting principles and to correct balances for erroneously recorded transactions. Due to the implementation of GASB 75, restated net position is comprised of a deferred outflow of \$89,824 and a net OPEB liability \$1,383,134.

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REQUIRED SUPPLEMENTARY INFORMATION

**KENTUCKY HEALTH BENEFIT EXCHANGE
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF PROPORTIONATE SHARE OF THE NET PENSION LIABILITY**

	Fiscal Year			
	2018	2017	2016	2015
HBE Proportion of the net pension liability (asset)	0.0591293%	0.074877%	0.096380%	0.070682%
HBE Proportionate share of the net pension liability	7,916,426	8,535,622	9,668,781	6,341,498
HBE Covered-employee payroll	892,589	1,221,266	1,488,340	1,115,012
Proportionate share of the net pension liability as a percentage of its covered-employee payroll	886.91%	698.90%	649.64%	568.74%
Plan fiduciary net position as a percentage of the total pension liability	13.30%	15.00%	18.83%	22.32%

This will be a 10 year schedule. Years will be added to this schedule in future fiscal years until 10 years of information is available.

**KENTUCKY HEALTH BENEFIT EXCHANGE
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF CONTRIBUTIONS-PENSION**

	2018	2017	2016	2015
Actuarially required contribution	\$ 374,808	\$ 467,094	\$ 502,092	\$ 368,089
Contribution in relation to the actuarial contribution	407,485	566,920	502,808	209,811
Contribution deficiency (excess)	\$ (32,677)	\$ (99,826)	\$ (716)	\$ 158,278
Covered-employee payroll	\$ 892,589	\$ 1,199,830	\$ 1,488,340	\$ 1,115,012
Contribution as a percentage of covered-employee payroll	45.64%	47.25%	33.78%	18.82%
Notes to Schedule				
Valuation date	June 30, 2016	June 30, 2015	June 30, 2015	June 30, 2014
Methods and assumptions used to determine contributions :				
Actuarial Cost Method	Entry Age	Entry Age	Entry Age	Entry Age
Amortization Method	Level percentage of payroll closed	Level percentage of payroll closed	Level percentage of payroll closed	Level percentage of payroll closed
Asset Valuation Method	20% of the difference between the market value of assets and the expected actuarial value of assets is recognized	Five-year smoothed market	Five-year smoothed market	Five-year smoothed market
Investment Return	7.50%	6.75%	7.50%	7.75%
Inflation	3.25%	3.25%	3.25%	3.50%
Projected Salary Increase	4.0%, average	4.0%, average, including inflation	4.0%, average, including inflation	4.5% per annum

Mortality

RP-2000 Combined Mortality Table, projected to 2013 with scale BB (set back one year for females)

This will be a 10 year schedule. Years will be added to this schedule in future fiscal years until 10 years information is available.

**KENTUCKY HEALTH BENEFIT EXCHANGE
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF PROPORTIONATE SHARE OF THE
NET OTHER POSTEMPLOYMENT BENEFITS LIABILITY**

	<u>2018</u>
HBE Proportion of the net OPEB liability (asset)	0.0644%
HBE Proportionate share of the net OPEB liability	1,634,231
HBE Covered-employee payroll	1,026,627
Proportionate share of the net OPEB liability as a percentage of its covered-employee payroll	159.18%
Plan fiduciary net position as a percentage of the total OPEB liability	24.40%

This is a 10 year schedule. Years will be added to this schedule in future fiscal years until the 10 years of information is available

**KENTUCKY HEALTH BENEFIT EXCHANGE
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF CONTRIBUTIONS OF THE NET OTHER
POSTEMPLOYMENT BENEFITS LIABILITY**
(Expressed in Thousands)

**Kentucky Employees Retirement Plan
Non-Hazardous**

		2018
<u>As of the most recent fiscal year end:</u>		
Actuarially determined contribution	\$	95,595
Contributions in relation to the actuarially determined contribution		98,522
Contribution deficiency (excess)	\$	(2,927)
 Covered-employee payroll		 1,171,490
Contributions as a percentage of covered-employee payroll		8.41%

Notes to Schedule as of the Measurement Date

Valuation date June 30, 2016

Methods and assumptions used to determine contributions:

Actuarial Cost Method	Entry Age Normal
Amortization Method	Level Percent of Pay 27 Years, Closed
Asset Valuation Method	20% of the difference between the market value of assets and the expected actuarial value of assets is recognized
Investment Return	6.25%
Inflation	2.30%
Projected Salary Increase	0%

Mortality

RP-2000 Combined Mortality Table, projected to 2013 with Scale BB (set back 1 year for females)

This is a 10 year schedule. Years will be added to this schedule in future fiscal years until 10 years of information is available.

**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**



MIKE HARMON
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*

Independent Auditor's Report

Adam Meier, Secretary
Cabinet for Health and Family Services
Robert Putt, Executive Director
Office of Health Data and Analytics

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's (KHBE) as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise KHBE's basic financial statements, and have issued our report thereon dated April 16, 2019.

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.

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 weakness 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 recommendations, we identified a certain deficiency in internal control that we consider to be material weakness and other deficiencies that we consider to be significant deficiencies.

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.



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)

We consider the deficiency described in the accompanying schedule of findings and recommendations to be a material weakness: 2018-KHBE-01.

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 deficiencies described in the accompanying schedule of findings and recommendations to be significant deficiencies: 2018-KHBE-02 and 2018-KHBE-03.

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*.

Kentucky Health Benefits Exchange's Response to Findings

KHBE's response to the findings identified in our audit are described in the accompanying schedule of financial statement findings. 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.

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 *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,



Mike Harmon
Auditor of Public Accounts

April 16, 2019

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

**KENTUCKY HEALTH BENEFIT EXCHANGE
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED JUNE 30, 2018**

2018-KHBE-01: The Kentucky Health Benefit Exchange Incorrectly Reversed A Prior Year Accrual Relating To Federal Grant Revenues Which Led To A Material Misstatement In The Prior Year

During the fiscal year (FY) 2018 audit of the Kentucky Health Benefit Exchange (KHBE), a material misstatement of \$168,176 was identified related to federal grant revenues. The error was determined to be a result of a prior year misstatement caused by an inaccurate reversal of a prior year accounting accrual. KHBE accepted an audit adjustment to correct the FY 2018 financial statements, resulting in a correction to increase federal grant revenues and a prior period restatement to reduce beginning total net position by \$168,176

KHBE double accounted for the reversal of prior year federal accounts receivable accrual, resulting in an understatement of federal grant revenues. Failure by KHBE to properly account for prior year reversal entries led to the error being carried forward into the FY 18 balances. This error resulted in a material understatement of KHBE's federal grant revenues and a material understatement of beginning total net position. As noted above, the agency accepted an audit adjustment to correct this error in the FY 2018 financial statements.

Proper internal controls require management to have sufficient procedures to ensure accurate accounting and financial reporting. Implementation of control activities should focus on the prevention, detection, and correction of errors and/or misstatements.

KHBE financial statements are presented on an accrual basis of accounting, which requires that revenues be recognized in the period in which they are earned. In the case of federal grants, revenues are considered earned when all applicable eligibility requirements have been met (GASB Cod Sec N50.118). Had it not been detected during the audit and corrected, the accounting error identified would have departed from this requirement under Generally Accepted Accounting Principles.

Recommendation

We recommend KHBE strengthen procedures of relevant accounting and financial reporting functions. In addition, improved monitoring controls over the accounting and reporting functions should be implemented to verify the completeness and accuracy of financial reports, as well as to improve the detection of errors.

Management's Response and Corrective Action Plan

The total amount of understatement of revenues of \$168,176 is less than one percent (0.8817%) of total fund balance and less than one percent (0.9831%) of total revenues for the year in question (FY2017). The error was of a non-cash nature; its effect upon the financial statements was one of revenue recognition, and the only question was whether the revenue was to be recognized in FY2017 or FY2018.

**KENTUCKY HEALTH BENEFIT EXCHANGE
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED JUNE 30, 2018
(Continued)**

2018-KHBE-01: The Kentucky Health Benefit Exchange Incorrectly Reversed A Prior Year Accrual Related To Federal Grant Revenues Which Led To A Material Misstatement In The Prior Year (Continued)

Management's Response and Corrective Action Plan (Continued)

Despite the immaterial amount, upon suggestion of the Auditors of Public Accounts (APA), we have revised the ending Accounts Receivable and Net Fund balances for fiscal year-end 2017, a year previously reviewed by APA, rather than allow the adjustment to be made to the current year FY2018, where it originally was reflected.

In order to mitigate this type of error from reoccurring, Division of General Accounting has established a set of procedures for creating and reviewing the HBE financials. These procedures are available upon request.

Auditor's Reply

The amount of the error did exceed tolerable misstatement for the FY 2018 KHBE audit. If this error was not corrected, it would have caused a material misstatement in the FY 2018 KHBE financial statements and would have resulted in a modified audit opinion.

**KENTUCKY HEALTH BENEFIT EXCHANGE
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED JUNE 30, 2018
(Continued)**

2018-KHBE-02: The Kentucky Health Benefit Exchange Did Not Pay Invoices Timely

This is a repeat finding. The previous year's finding, 2017-001, was included in the fiscal year 2017 report.

Fiscal Year 18 testing indicated KHBE failed to meet the guidelines set forth in KRS 45.453 pertaining to timely payment of invoices from vendors. During the period of audit, evidence provided for the sample items tested indicates that eight invoices were paid more than 30 business days after the date of invoice.

Delayed payment of vendor invoices may increase the risk of a misstatement of expenditures in the financial statements, as well as increase costs for the agency if the vendor enforces the 1% penalty for invoices paid past 30 business days.

KHBE failed to ensure that all invoices received were paid timely in accordance with KRS 45.453, which allows 30 working days from the date of the vendor's invoice to pay.

According to KRS 45.453, "All bills shall be paid within (30) working days of receipt of goods and services or a vendor's invoice except when the purchasing agency has transmitted a rejection notice to the vendor." Additionally, KRS 45.454 states, "An interest penalty of one percent (1%) of any amount approved and unpaid shall be added to the amount approved for each month or fraction thereof after the thirty (30) working days which followed receipt of the goods or services or vendor's invoice by a purchasing agency."

Recommendation

We recommend payments be made timely in accordance with legal requirements. Internal controls should be developed and implemented to ensure timely processing and payment of invoices in compliance with legal requirements. Implementing adequate procedures for personnel involved in processing and approving payments to avoid late penalties assessed by vendors should be considered.

Management's Response and Corrective Action Plan

The Cabinet for Health and Family Services (CHFS) agrees with the finding. The Division of General Accounting (DGA) has posted all payment policies and procedures on the CHFS intranet. DGA will send notifications to all departments that these policies are available and will make all departments aware of the time frame in which payments have to be made. In addition, DGA is now using the Kentucky Invoice Tracking System (KITS) to track all invoices. KITS automatically records the date an invoice is entered into the system. DGA monitors the time lapse between when an invoice is initially received and when it is uploaded. DGA management will flag invoices that have a large time gap and email the uploader to ensure this does not happen in the future. In addition, DGA runs a report every morning that flags invoices approaching the 30-day mark, which is then sent to all DGA management. This system along with intranet payment policies should help prevent late payments.

**KENTUCKY HEALTH BENEFIT EXCHANGE
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED JUNE 30, 2018
(Continued)**

2018-KHBE-03: The Kentucky Health Benefit Exchange Processed Duplicate Payments In The Amount of \$133,369 To The Wrong Vendor

During the fiscal year 2018 audit of the Kentucky Health Benefit Exchange (KHBE), internal controls were tested to verify and ensure the accuracy, timeliness and completeness of invoice processing and payments to vendors. Review of supporting documents indicated that the agency erroneously made duplicate payments for four different invoices which resulted in duplicate payments of \$133,369. Supporting documentation indicates that the error in each case was found by the vendor.

Additionally, another payment was made to the incorrect vendor in the amount of \$31,307. The vendor that was paid in error realized the mistake and returned the uncashed check 30 days later. The agency issued a payment of \$31,307 to the correct vendor more than 30 days after the invoice date.

The agency did not have a procedure in place to individually identify invoices from vendors. Since the discovery of the \$133,369 in duplicate payments, the Division of General Accounting (DGA) payables department has issued a standard procedure called "Smart Codes."

Vendor numbers are not hard coded into contracts. When a contract is referenced during the creation of the payment, the vendor number is manually entered by staff. In this case the vendor number was not entered correctly, resulting in \$31,307 paid to an incorrect vendor. Reviews are conducted by one of three different DGA payables staff. The DGA payables staff has access to the supporting documentation in eMARS and are supposed to verify the supporting documentation before approving the payment. If all details of the payment are not approved accordingly a payment could be made erroneously. In this particular situation, after the erroneous payment was detected by the vendor the corrected payment was made after the 30 day time limit.

Sound accounting procedures dictate that internal controls be established in order to prevent errors, fraud, waste, and abuse. Implemented internal controls should be documented, well designed, and approved by management. Management should fully support its control environment, as a control structure that is easily circumvented is inadequate and ineffective.

Recommendation

We recommend the agency improve its internal control procedures and require all staff to follow the established procedures. Required processes should be communicated in policy and procedure manuals, such as the agency's enforced "smart codes," to ensure expectations are clearly defined.

**KENTUCKY HEALTH BENEFIT EXCHANGE
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED JUNE 30, 2018
(Continued)**

2018-KHBE-03: The Kentucky Health Benefit Exchange Processed Duplicate Payments In The Amount of \$133,369 To The Wrong Vendor (Continued)

Management's Response and Planned Corrective Action

The Cabinet for Health and Family Services (CHFS) agrees with the finding. This payment was made in eMARS 3.10. The documents in question had the wrong vendor code listed on them, which caused the wrong vendor to be paid. CHFS is now using eMARS 3.11 and has changed the process for ensuring the correct vendor code is used by looking at the address. The Division of General Accounting (DGA) will not use a vendor code that does not have a matching address to the invoice unless it has been verified. If a matching address is not found, DGA will ask the department to modify the vendor, so that a matching address will be available for the future. This internal control will prevent this issue from happening again.

In order to prevent duplicate payments, CHFS Division of General Accounting (DGA) is now using a new system to track invoices called the Kentucky Invoice Tracking System (KITS). Using this system along with smart coding all documents should prevent duplicate payments.