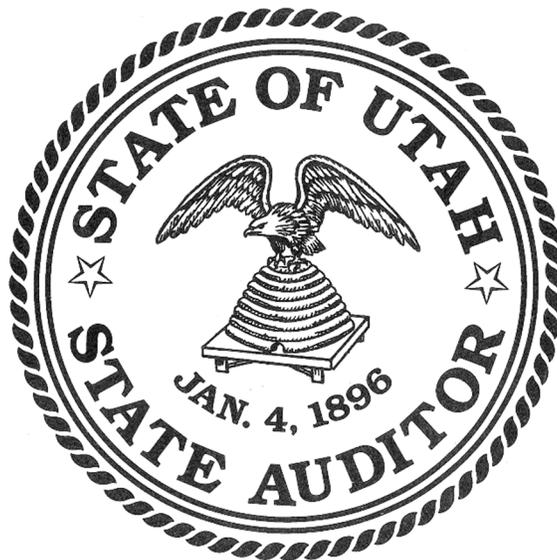


PUBLIC EMPLOYEES HEALTH PROGRAM

Single Audit Management Letter
For the Year Ended June 30, 2018

Report No. 18-16



OFFICE OF THE STATE AUDITOR

AUDIT LEADERSHIP:

John Dougall, State Auditor
Gregg Hastings, CPA, Audit Manager
Andrew Driggs, Audit Senior

PUBLIC EMPLOYEES HEALTH PROGRAM

**Single Audit Management Letter
FOR THE YEAR ENDED JUNE 30, 2018**

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OFFICE OF THE
STATE AUDITOR

SINGLE AUDIT MANAGEMENT LETTER NO. 18-16

December 11, 2018

Mr. R. Chet Loftis, Director
Public Employees Health Program
560 East 200 South
SLC, Utah 84102-2099

Dear Mr. Loftis:

This management letter is issued as a result of the Public Employees Health Program's (PEHP's) portion of the statewide single audit for the year ended June 30, 2018, for which we tested PEHP's working capital reserves. Our final report on compliance and internal control over compliance issued to meet the reporting requirements of Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) is issued under separate cover.

In planning and performing our audit of working capital reserves, we considered PEHP's compliance with the applicable types of compliance requirements as described in the *OMB Compliance Supplement* for the year ended June 30, 2018. We also considered PEHP's internal control over compliance with the requirements described above that could have a direct and material effect on working capital reserves in order to determine the auditing procedures that were appropriate in the circumstances for the purpose of expressing an opinion on compliance and to test and report on internal control over compliance in accordance with the Uniform Guidance, 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 PEHP'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 to detect and correct on a timely basis noncompliance with a type of compliance requirement of a federal program. *A material weakness in internal control over compliance* is a deficiency, or a 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 that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We did not identify any deficiencies in PEHP's internal control that we consider to be material weaknesses.

Our consideration of internal control over compliance was for the limited purposes described in the second paragraph and was not designed to identify all deficiencies in internal control over

compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls.

We identified an instance of noncompliance which we are required to report under Uniform Guidance. This matter is described in the accompanying finding and recommendation.

PEHP's written response to and Corrective Action Plan for the finding identified in our audit were not subjected to the audit procedures applied in our audit and, accordingly, we express no opinion on them.

The purpose of this communication is solely to describe the scope of our testing of internal control over compliance and the results of that testing. Accordingly, this communication is not suitable for any other purpose.

We appreciate the courtesy and assistance extended to us by the personnel of PEHP during the course of our audit, and we look forward to a continuing professional relationship. If you have any questions, please contact me.

Sincerely,

A handwritten signature in cursive script that reads "Gregg Hastings".

Gregg Hastings, CPA
Audit Manager
801-808-0293
ghastings@utah.gov

cc: Rob Dolphin, CPA, CGMA, Controller, PEHP
John Reidhead, Chief Financial Officer, State Division of Finance

WORKING CAPITAL RESERVES IN EXCESS OF FEDERAL GUIDELINES

Federal Agencies: **Various**

CFDA Numbers and Titles: **Various**

Federal Award Numbers: **Various**

Questioned Costs: **Undeterminable**

Pass-through Entity: N/A

Prior Year Single Audit Report Finding Numbers: **2017-023, 2016-039; 2015-050; 2014-042; 2013-050; 12-53; 11-58**

As of June 30, 2018, the Public Employees Health Program (PEHP) held working capital reserves in excess of federal guidelines as follows:

<u>Program</u>	<u>Excess # of Days in Reserve</u>	<u>Excess Amount in Reserve</u>
State Medical	24	\$ 21,094,250
State Dental	6	\$ 273,786
Long-Term Disability	692	\$ 7,135,726
Medicare Supplement	81	\$ 10,719,664

2 CFR part 200, Appendix V, paragraph G.2, generally allows for a working capital reserve as part of retained earnings of up to 60 days cash expenses for normal operating purposes. It is inherently difficult to accurately estimate expenses and their effect on working capital reserves when setting rates. Excess reserves could result in a federal liability since federal programs share an interest in the reserves.

Recommendation:

Depending on the business requirements, we recommend that PEHP reduce excess working capital reserves or obtain a waiver from the federal cost negotiator allowing for an increase in the number of days of working capital allowed to comply with federal guidelines.

PEHP's Response:

PEHP is aware the State Medical, State Dental, Long-Term Disability, and Medicare Supplement programs have reserves in excess of the federal guidelines. PEHP's plan to reduce these excess reserves over several years is going forward as approved by Cost Allocation Services.

Corrective Action Plan:

State Medical – As previously agreed with Cost Allocation Services (CAS), PEHP has submitted to CAS a proposed federal refund calculation for the excess reserve balance in this program as of June 30, 2017. CAS is still in the process of reviewing this calculation. For the fiscal year ending June 30, 2018, the state renewal rates were increased 6.5%. Due to favorable claim

experience and cost cutting measures, actual results were much better than expected in this program. As a result, the rate for this program for fiscal year ending June 30, 2019 was decreased to 4.35%, which is expected to meet medical trend costs and help in drawing down the reserves in this program.

State Dental – PEHP paid out a \$4 million experience dividend to reduce the excess reserves in this program in fiscal year 2017. PEHP also did not increase the premium rate for this program for fiscal year 2018 and decreased the rate 2.89% for fiscal year 2019. PEHP expects the decreased rate will eliminate the small excess reserve balance left in this program by June 30, 2019. Because of this, PEHP plans to request approval from CAS for an additional year from the previously agreed upon excess reserve elimination deadline date of June 20, 2018. However, if there is still an excess reserve at June 30, 2019, PEHP plans on refunding the federal portion of the excess reserve balance as of that date.

Long-term Disability – PEHP paid out a \$5.5 million experience dividend to reduce the excess reserves in this program in fiscal year 2017. PEHP also lowered the premium rate for this program from 0.6% to 0.5%. PEHP has requested the Division of Finance to calculate the federal portion of the excess reserve balance in this program as of June 30, 2018, and to submit it to CAS for approval, as previously agreed with CAS.

Medicare Supplement – Due to the large changes in the reserve for this program, the rate for calendar year 2018 was decreased 5.6% from the prior year. The rate for calendar year 2019 was increased 3% and is expected to meet actual medical trend costs. This program has recently had favorable claim experience and received pharmacy subsidies greater than expected amounts. Due to the large net changes in the reserve in this program over recent fiscal years, PEHP plans to request approval from CAS for an additional year from the previously agreed upon excess reserve elimination deadline date of June 20, 2019, in order to study the underlying actuarial data for this program to determine if in fact an excess reserve exists. If it is determined that there are excess reserves as of June 30, 2020 in this program, PEHP will refund the federal portion of the excess reserve balance as of that date.

Contact Person: Robert Dolphin, Finance Director, (801) 366-7429

Anticipated Correction Date: June 30, 2020